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BOOK REVIEWS

1950 Edition of Departmental Merchandising and Operating of Department Stores and Specialty Stores

Controllers' Congress of the NATIONAL RETAIL DRY GOODS ASSOCIATION, New York, N. Y., 1950. Pages: 122; $10.00.

This is the 25th annual edition of a compilation by the Controllers' Congress of the National Retail Dry Goods Association of departmental merchandising and operating results—"M.O.R." as it is called in trade circles. It brings together departmental data of over 400 stores throughout the country for the year 1949. There are 21 types of data as to each department, such as cumulative mark-up, mark-downs, gross margin, sales per square foot and average gross sales. Separate tables are presented for department stores of six sales volume groups and for specialty stores of two sales volume groups, in addition to the overall tables for all stores.

While the format of the book is quite similar to the 1949 edition, the grouping of the tables has been revised. Whereas in prior years the "goal" tables for each size of store followed the typical or average tables, the 1950 edition has grouped the typical and the "goal" tables in separate sections. The use of heavy tabbed sheets to divide the sections of the book is of considerable help in locating the various tables for reference purposes, which is the prime use of these publications. A section dealing with publicity expenses has been added; such data had previously been issued by the Association separately. While this publicity data, in some respects, duplicates that contained in the Harvard publication on operating expenses of department stores, yet the division of the total cost into newspaper space, direct mail, radio, other advertising media, etc., is interesting.

Being a silver anniversary issue, a special section entitled "A Quarter Century of Retailing" has been added. This section shows in tabular form total store data regarding merchandising, sales, inventory, expense and profit for each of the years 1925 through 1949. The regional data by Federal Reserve districts continue to occupy a section of the book as they have each year since 1946.

The text material in the current report has been reduced somewhat in comparison with prior years. The use of bar graphs, pie charts, and similar visual presentation has been continued. The reduction of the text and the use of two colors of ink and several type styles make this section fast and easy reading.

The new edition represents an improvement over what has always been regarded as an outstanding piece of work in the department store field.

J. P. FRIEDMAN

New York, N. Y.

Basic Cost Accounting

By Samuel Waldo Specthrie. PRENTICE-HALL, INC., New York, N. Y., 1950. Pages: xi + 299; $5.00.

Use of the word "basic" in the title gives a connotation, if not denotation, of something fundamental, as a statement of principles. However, a reading of the book leaves one with a feeling that the principles of cost accounting have been submerged in methods and bookkeeping procedures.

The book is (as stated in the preface) intended as a text for students, presumably college students. At the end of each of the 20 chapters there are review questions and problems.

Four of the first five chapters deal principally with definitions of costs, its uses, and the elements of direct material and direct labor (one of the chapters, #3, describing job lot cost, seems poorly placed in the early part of the book).

Six chapters are devoted to indirect expenses or factory burden. Normal volume is advocated for the distribution of indirect expenses, but meaning of the term "normal" is not explicit. It is left to the reader to decide whether normal refers to capacity, an average year in a business cycle, or the current year. Some accountants will disagree with the author's opinion that underabsorbed expense is carried as an asset until year end and then reported in the earnings statement as the last item immediately before showing the amount transferred to "surplus" (an obsolete term?).

Chapter 11 concerns the bookkeeping for finished goods and their sale; chapter 12 is also concerned to a large extent with bookkeeping and general accounting—the preparation of financial statements (which, strangely in this period of high income taxes, contains no discernable provision for federal income taxes). One and a half pages are devoted to the ruling off of accounts in the general ledger.

In the last seven chapters, the discussions of topics such as cost standards, operational cost, by-products, break-even points are the ones most likely to interest readers who seek knowledge of basic cost accounting.

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Book Reviews

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To this reviewer the book is disappointing in its poor adherence to its title, particularly because so much attention is given to the doctrinaire methods and bookkeeping procedures and so little to the exposition of principles of cost accounting.

J. A. Dowling

New York, New York.

Cost Accounting

By Charles Reitell and Gould L. Harris. International Textbook Company, Scranton, Pa., 1950. Pages: xii + 692; $7.50.

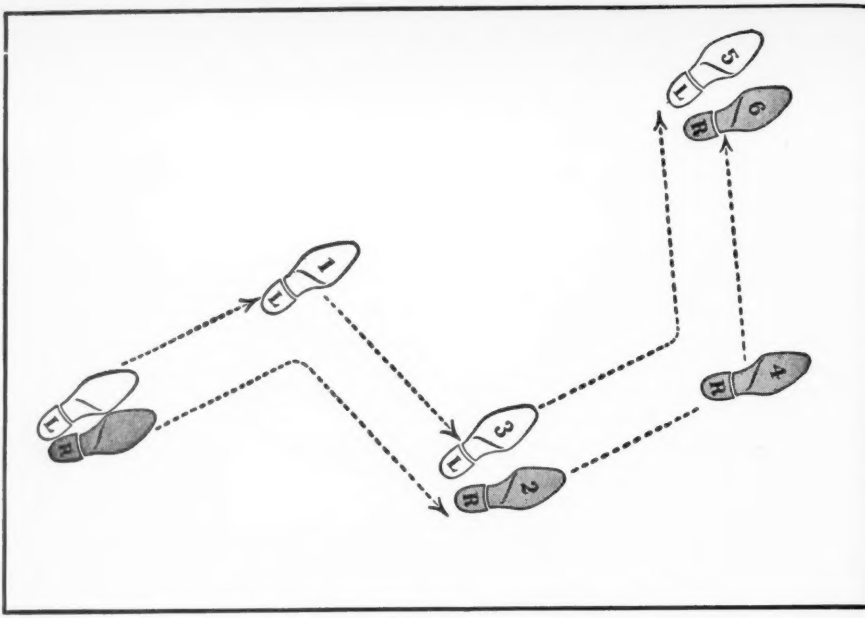
The approach to the subject of Cost Accounting by Messrs. Reitell and Harris is not only practical, but also puts the reader in a receptive frame of mind. Instead of commencing in a dull uninteresting manner, such as is typical of so many textbooks, the authors take great pains to stress the importance of cost accounting as it affects the operations of an industrial enterprise. Quite wisely, they explain how cost accounting becomes an integral factor in the determination of company policy and financial control. Not only do they dwell upon the significance of cost accounting as regards company policy and financial control, but they carry the importance of their subject to the most necessary function of any enterprise—that of marketing the company's finished products.

After reading the first four chapters which dwell, for the most part, on the aforementioned concepts, the reader should be thoroughly impressed with the role played by cost accounting as a tool of management. Not only should the reader be impressed, but in addition he should be inquisitive as to the mechanics and procedures of such an important phase of industrial accounting. His frame of mind should be receptive to the concepts of cost accounting which are to follow.

Having ably stressed the functions of cost accounting the authors proceed to define the more important terms of the subject, such as direct and indirect costs, raw material costs, labor cost, and factory overhead. However, the definition phase of the book seems to be overdone, and in many instances too much space is consumed in the description of such things as voucher registers, check registers, and inventory valuations. Surely, a student embarking on a course in cost accounting would be completely familiar with these accounting techniques. A brief review of these terms—at the most—should suffice.

Instead of continuing with descriptive and explanatory material from Chapters V through XXII it would have been more beneficial to the student had the authors dealt with the mechanical aspects of the subject earlier in the text. While the importance of a working knowledge of the method of inventory taking, purchase procedures, plant lay-

(Continued on page 577)



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Book Reviews

(Continued from page 575)

out, payroll distributions, timekeeping and stock records are of immeasurable value to the cost accountant, it seems logical that these phases of an industrial organization would be more properly handled in conjunction with a complete illustration of a simple cost problem. In this manner the various forms and auxiliary paper work could be introduced as the source of various figures on a completed cost schedule. The simple cost problem would have been expanded into an increasingly complex cost schedule, until the authors had disposed of the various and sundry types of paper work that are used by an industrial organization in the compilation of their cost schedules.

The actual mechanics of cost accounting, which commences with Chapter XXIII, are well handled by the authors. Their discussion and illustrations of labor costing, factory overhead, process costing and job order costing adequately cover the accounting principles as they apply to the two basic types of cost systems. Having read this section of the text one should be able to visualize the costing procedure of an industrial organization, at least so far as the basic operations of the cost system are concerned.

An equally efficient job was done by the authors in the chapter on Standard Costs and Budgets for Marketing.

The authors have covered all the phases of cost accounting and in addition have given the reader an opportunity to become somewhat familiar with the paper work used in actual practice. This is one of the stronger selling points of the text, in that it not only presents the theoretical aspects of cost accounting, but enables the student to obtain an insight to the application of these principles as they are used in the business world.

L. W. Buffinton
New York, New York.

Principles of Accounting: A Diagrammatic Approach

By John R. Bangs, Jr. and George R. Hanselman. International Textbook Company, Scranton Pa., 1950. Pages: xi + 521; $6.50.

This is the second and revised edition of the text, Accounting for Engineers, which was first published in 1941. The authors, in the foreword to the first edition, suggested its use as a text for a one-semester, terminal, elementary accounting course, and since the revision is very minor in character, one may assume that the original purpose has been retained. Because the standard elementary accounting books are planned for use in a two-semester course, slight basis exists for a comparative evaluation of the work. Its limitations of scope, content and development, are inherent in the authors' goal. It is this reviewer's opinion that a one-semester terminal accounting course is impracticable, and any text designed for that end would be wanting. Any attempt in that direction would be unjust to the student, who would be served a concoction which would be neither fish nor fowl, as the saying goes.

The book is divided into four parts. Part I, containing eight chapters, is devoted to the development of the theory of debit and credit. Part II contains five chapters and deals with adjusting entries. Part III is entitled Accounting Practice and the six chapters present the subject of books of original entry. The last part consists of six chapters and covers the areas, business papers and procedures, statement analysis, depreciation, and manufacturing and cost accounting.

The book is characterized by a conscientious attempt to present lucidly the fundamental processes of bookkeeping and accounting. As a teaching technique the authors employ a device which they term a Diagrammatic Ledger. This is the familiar "T" account form of ledger with the accounts placed entirely on one page and under the appropriate headings which are designated as, Assets Division, Liabilities Division, and Temporary and Permanent Net Worth Divisions. By placing all the accounts on the one page and under the appropriate division, the device is calculated to facilitate the comprehension by the student of the effect and relationship of the "keyed" entries. The authors stress the pedagogical importance of diagrams, with which the book is replete, in various and ingenious forms.

As a result of a concentration upon fundamental principles and procedures, the following topics, amongst others, which are customarily included in elementary accounting books, are either entirely omitted or only cursorily presented: partnership accounting, accounting for individual proprietorships, corporate capital accounts, bonds, sinking funds, and sinking fund reserves, notes receivable and payable, notes receivable discounted, and related accounting for interest problems.

Because of their indicated purpose, the authors have been impelled to adopt a rather casual attitude towards accounting theory. Such matters as the valuation of fixed assets and inventories are only tenuously and sketchily considered. The circumscribed area which they have allowed themselves in this respect has, moreover, made for inaccuracies. Thus, in distinguishing current from non-current assets, the statement is made (p. 47) that "an item to be current should expire within one year as a rule, and within two years at

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EMANUEL SAXE, *Managing Editor*

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Some Notes on the Observation of Physical Inventories

By GEORGE C. WATT, C.P.A.

TAKING physical inventory is expensive and usually plants are shut down within the work-week to avoid paying overtime. It is also important to management that very little production be lost within the selected work-week. Consequently, the time allotted is extremely short, seldom exceeding two days.

Physical inventories in industries such as mining, logging, retail selling, petroleum, are highly specialized. On the other hand the great majority of physical inventories of manufacturing companies are taken on two-part pre-numbered tags and the procedures followed by such companies using tags are generally similar. Public accountants observing these procedures likewise follow audit procedures that are similar.

The client has the advantage of having plant employees experienced in taking his particular inventory, having tailor-made written instructions, having control work sheets prepared in advance showing tags issued. A day or so in advance of the plant shutdown the items that won't be moved or used before completion of the physical inventory are counted and tagged.

Under these conditions the public accountant must also be well-organized before the start of the inventory-taking so that administrative problems do not detract from the limited time available for observation.

It is advantageous to make use of the organizational material of the client by arranging to receive (at least two weeks in advance of the inventory-taking) a copy of the inventory instructions prepared by the client for the use of his employees in counting and listing, foremen in test-checking the description on the tags, department heads in controlling the issue of and accounting for tags, office personnel in sorting and tabulating the used tags, and accounting employees in pricing the individual items after tabulation. Request in advance that the plant accountant

GEORGE C. WATT, C.P.A., has been a member of the Society since 1948, and is a Certified Public Accountant of New York, Pennsylvania, Indiana and Kentucky. He is also a member of the American Institute of Accountants and has been a contributor to the Journal of Accountancy.

From 1942 to 1946, he served in the Navy Cost Inspection Service where he held the rank of Lieutenant Commander.

Mr. Watt is a manager with Price, Waterhouse & Co., C.P.A's.

prepare in duplicate his work sheet which lists departments and shows the blocks of prenumbered tags issued to each department head, so that a copy can be furnished to the public accountant upon his arrival at the plant. With the insertion on this work sheet (adjacent to the name of each department) of the total dollar value in each department at the time of the previous physical inventory (or, better, the most recent month-end book figures, if available), the assistant in charge of the observation, even if he has never seen the plant before, is in a position to assign assistants under his supervision to various departments so as to distribute responsibility among them equitably.

In general, no appreciable time or effort is required for the process of observation, which includes seeing that the plant has ceased operations, that prenumbered tags are used and accounted for, that employees have received instructions in writing, that cut-off data at the shipping and receiving departments will insure that current sales and vendors' invoices can be properly recorded in the general books in relation to the material tagged (usually the adequacy of the company's records has been established by prior engagements), that employees counting inventory are competent and thorough.

On the other hand, the specific tests recorded by the public accountant during the observation do require the application of detailed programs to provide tests of the accuracy of quantities shown on the finalized inventory when it is submitted some 10 to 40 days after the physical inventory. At that time the public accountant should be in a position to make tests designed to detect *omission* of tags which were written at the time of the physical inventory, or subsequent *alterations* of tags, or what is far more difficult to detect, the *subsequent inclusion* in the finalized inventory of tags which were written after completion of the physical inventory.

Some prepared forms used by the author to attain these objectives on a recent engagement are shown on the following pages. They may be described as follows:

Exhibit I—Brief reminders to the *Assistant-in-Charge.*

Exhibit II—Specific instructions to each of the *assistants* working under the direction of the assistant in charge.

Exhibit III—A form which, upon completion, furnishes data for a check (some 10 to 40 days later) for tags added by the client some time after the count (whether correctly or *falsely*) to support the finalized inventory sheets.

Exhibit IV—A form upon which to record specific counts observed or made by the assistant. When these counts are compared to the finalized inventory sheets some 10 to 40 days after the inventory-taking, this data is used to detect *omission* or *alteration* of original inventory counts.

The feature of the form is, however, the column at the extreme right which should be left blank at time of the inventory-taking. This column is completed some 10 to 40 days later when these counts are compared to the finalized inventory sheets. Often this work is done by another assistant. (It does not take additional time to approximate mentally and then write in the approximate dollar amount of the items during this work.) By footing this column on all such work sheets and running an adding machine tape of the total on all such work sheets the total dollar amount of inventory observed is easily determined. Such a figure is of vital interest to those in charge of examinations.

EXHIBIT I

Name of client: ______________________________
Address of plant: ____________________________

PHYSICAL INVENTORY WORK PROGRAM
CHECK LIST FOR ASSISTANT IN CHARGE
TAG INVENTORY

Assistant in charge

1. Obtain a copy of the client's inventory instructions (preferably two weeks prior to the inventory date) and review, requesting revisions, if necessary. Agree on <u>method</u> of pricing which will be consistent with preceding year.
2. Obtain a copy of the client's work sheet which lists the names of the departments, names of department heads, serial numbers of tags issued to the department heads, and insert thereon the dollar value in each department at last inventory or at the last monthly closing. From this data assign assistants to selected departments.
3. Give assistants an opportunity to read "carry forward" data on the departments to which they have been assigned. Then introduce the assistants to the client's department heads with whom they will be working and show them the locations and problems involved.
4. See that the plant accountant is taking responsibility for control of tags during the inventory and subsequent accounting for their use.
5. Arrange for cut-off tests:
   Receiving reports-- Record last serial number and ascertain that related material through that number is tagged.
   Shipping orders and bills of lading-- Record last serial number and ascertain that goods left plant.
   Requisitions between raw material, work-in-process, finished goods-- See that requisitions still on hand in the plant are dated and posted before the inventory date and that employees are instructed to date subsequent requisitions "after the count."
   Partial completion entries on orders from work-in-process to finished goods-- See that system provides for such entries as well as entries for partial shipments out of the plant.
   R. R. cars on track-- Obtain car number and initials, contents, and status of seal.
6. Ascertain that physical (tags) will be compared with perpetual records by the client in order that client may investigate large differences immediately.
7. Inquire if there are goods which are not owned but are on consignment from others. Arrange for confirmation. (Price tests should disclose if client failed to identify such items and <u>falsely</u> added them to inventory.)
8. Inquire if goods, the title to which has passed to the customers, have been set aside and excluded from the inventory. Arrange for confirmation.
9. Inquire into the handling of intercompany or interdivision transfers over the cut-off period. Record sufficient shipping and receiving data to test check the procedures and to provide data for cross reference to similar tests made at other subsidiaries or divisions by our assistants there.
10. If physical inventory is not exactly on close of business of year end or month end, inquire into labor accruals and provisions for recording movement of material.

Name of assistant in charge ______________________________

Dates client took physical counts ______ / / ______ to ______ / / ______ incl.

Dates of observations ______ / / ______ to ______ / / ______ incl.

EXHIBIT II

Name of client: ______________________
Address of plant: ____________________

PHYSICAL INVENTORY WORK PROGRAM
INSTRUCTIONS TO ASSISTANT
TAG INVENTORY

Assistant		
Dept.	Dept.	Dept.

1. You have been furnished a copy of the client's instructions. See that the employees are following these instructions. If some instruction is not being followed, discuss the matter with the company's department head. If the matter is not corrected, advise the assistant in charge.
2. Make test counts along with the company's inventory crews and also make some tests of completed tags. Record tests on work sheets provided (Exhibit IV). Such counts at random furnish material for later tests to detect if there has been omission or alteration of original physical inventory data.
3. In order to greatly increase the volume of the tests, sight test quantities on some completed tags by comparison with amounts on tags representing similar items which you observed while they were actually counted (in paragraph (2) above), but indicate by an asterisk on Exhibit IV which items you sight tested as described in this paragraph.
4. When a section to which you have been assigned is complete, review the entire department quickly with a representative of the client's accounting department and the department head and all agree that work is complete. Orally authorize the department head to lift the tags and to account for consecutive numbers at his office (used, unused, voided).
5. At the department head's office, after he has accounted for tags assigned to him (on Exhibit III provided):
   (a) Record the day and hour you authorized the tags to be lifted.
   (b) Record tags originally assigned to the department head.
   (c) Record all large blocks of unused tags and inspect generally.
   (d) Select a consecutive number, say 400, of originally issued tags and account for all serial numbers (just as company did) by recording the serial numbers of the "used" "unused" "voided" to total, say 400.
   (e) Make any general comments deemed important and in addition make inquiries about slow-moving materials. Indicate that you believe the inventory was well conducted, and/or offer your suggestion for improving the client's procedures.
6. To obtain a test for false inclusion at the department head level select several of the "used" tags accounted for in paragraph 5(d) above and list them on a work sheet (as in paragraph 2 above) and locate and count the material. Label this work sheet "Test counts selected from tags after all tags were accounted for by department head."
7. Turn in your work sheets for review. A separate set of work sheets is required for each department.
8. Trace some items recorded on your work sheets at time of physical count to perpetual records and scrutinize perpetual records for slow-moving and obsolete items. See that client is doing this 100%. If you are unable to trace to book records for lack of time, put a "To Do" note in the front of the file.
9. Revise (or create) "carry forward" data describing the client's method of taking physical inventory in this department.

Date
Initials

EXHIBIT III

Name of client: ______________________________

Address of plant: ____________________________ Department

After department head has completed accounting
for consecutive numbers of tags originally
issued to him, record

(a) Time and day authorized tags to be lifted in cooperation with representative of client's accounting department.

(b) Tags originally assigned to the department head, Mr. __________.

From #	To #	Total

(c) Large blocks of unused tags (list after department head has accounted for tags)*

From #	To #	From #	To #	From #	To #	Total

*At a later date it will be ascertained that these are still unused, as a test for items added to the finalized inventory after count.

(d) Selective test of consecutive tag numbers (# to #) = ______ (A)

(A) ACCOUNTED FOR AS FOLLOWS:

Used			Unused*			Voided
From #	To #	Total	From	To #	Total	Listed by tag #

(e) Comments:
General

Obsolete and slow-moving items

Conclusion

Date
Initials

EXHIBIT IV

Name of client: ________________________

Address of plant: ________________________ Department

OBSERVATION OF PHYSICAL INVENTORY
TEST COUNTS

Plant / Department / Tag #	Description	UNIT	Quantity per tag counted	Traced (in round amount to be entered below) to $ listing on finalized inventory

Note - It is more important to observe that the crews of the client are doing an accurate job of counting and are entering on tags sufficient data to enable accurate costing at a later date than to list a great many counts hereon.

Date
Initials

The Accountant's Opinion Before and After Auditing Procedure Statement No. 23

By Stephen Chan, C.P.A.

It is regrettable that many CPA's do not keep abreast of developments in the field of public accountancy. The profession has not stood still and its practice and procedures are gradually changing; the changes are reflected in the accounting and auditing bulletins and pronouncements of The American Institute of Accountants.

As an illustration, let us review the accountant's opinion, or, as it was formerly known, the accountant's certificate.

Accountant's Certificate

Prior to the *Ultramares* case, the accountant's certificate read somewhat as follows:

> "We have audited the books of account of the ABC Company for the year ended December 31, 1925, and hereby certify that the accompanying balance sheet and profit and loss statement correctly present the company's financial condition at December 31, 1925, and its operating results for the year then ended."

Stephen Chan, C.P.A., is a member of the Society and also holds membership in the National Association of Cost Accountants, the American Institute of Accountants and the American Accounting Association. He is presently serving as a Director of the Society and Chairman of the Publications Committee.

Mr. Chan has written a number of articles which have appeared in the *Journal of Accountancy*, the *Canadian Chartered Accountant*, *The New York Certified Public Accountant*, and other publications. He is a partner in the firm of Eisner & Lubin, C.P.A's.

After the *Ultramares* case and similar disturbances, the majority of practitioners added the words "in our opinion" immediately following . . . "hereby certify that" . . . in the foregoing form of certificate.

Accountant's Report

The use of the term, "accountant's certificate," and the words, "we hereby certify", persisted generally until 1934, when, in the pamphlet "Audits of Corporate Accounts", the American Institute of Accountants published the report of its special committee on co-operation with Stock Exchanges, which contained this comment:

> "We think it desirable to emphasize the fact that accounts, and consequently any statements or reports based thereon, are necessarily in large measure expressions of opinion. To this end, we think it desirable that the document signed by the accountants should be in the form of a report, as in England, rather than a certificate, and the words "in our (my) opinion" should always be embodied therein. It is impracticable to indicate in a standard form of report exactly the procedure followed, since it will vary in different cases, and it will be desirable to use language which may understate what has been done rather than to incur the risk of the extent of the examination being exaggerated by the reader."

The suggested form of accountant's report, follows:

> "To the XYZ Company:
>
> We have made an examination of the balance sheet of the XYZ Company as at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income

accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination, the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review, its position at December 31, 1933, and the results of its operations for the year."

This form was accompanied by the committee's suggestions, three of which are set forth below:

"It is contemplated that before signing a report of the type suggested, the accountant should have at least made an examination of the character outlined in the bulletin, 'Verification of Financial Statements'."

"This certificate is appropriate only if the accounting for the year is consistent in basis with that for the preceding year. If there has been any material change either in accounting principles or in the manner of their application, the nature of the change should be indicated."

"It is contemplated that the form of report would be modified when necessary to embody any qualifications, reservations or supplementary explanations."

The foregoing recommendations represented a forward step towards uniformity of meaning in the auditor's report, and were generally followed by the larger accounting firms. However, many smaller practitioners persisted in using the words "we hereby certify." Also, some firms used those words without first making a complete audit or verification.

Early in 1939, because of disclosures stemming from a celebrated fraud in a publicly owned corporation, the annual reports of which had been audited by an internationally known accounting firm, the American Institute and the New York State Society appointed special committees to review prevailing auditing practices.

Institute Bulletins

There resulted in October, 1939, the first of the American Institute's Statements on Auditing Procedure, entitled "Extensions of Auditing Procedure."

This complete Statement No. 1, comprising twelve pages, should be carefully reread by every practitioner since, despite the lapse of more than ten years, many Certified Public Accountants still do not follow its prescribed procedures.

The following short form of Independent Certified Public Accountant's Report or Opinion, was set forth in Statement No. 1:

"To the Board of Directors (or stockholders) of the XYZ Company:

We have examined the balance sheet of the XYZ Company as of April 30, 1939, and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate.

In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the XYZ Company at April 30, 1939, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

In February, 1941, the Securities and Exchange Commission (which has done much to clarify and codify accounting practice) suggested the addition of one sentence to the standard form of certificate. This resulted in the following addition to the first paragraph of the foregoing standard form of report.

"Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary." (Statement on Auditing Procedure No. 5—February, 1941.)

To clear up misunderstandings, the Institute's Committee on Auditing Procedure recommended in its Statement No. 12, dated October, 1942,

"that, hereafter disclosure be required in the short form of independent accountant's report or opinion in all cases in which the extended procedures regarding inventories and receivables set forth in 'Extensions of Auditing Procedure' are not carried out, regardless of whether they are practicable

and reasonable, and even though the independent accountant may have satisfied himself by other methods."

Present Form of Accountant's Report

The general form of accountant's report remained unchanged until 1948. Then, in Statement No. 24, issued in October, the following revised form was presented:

"We have examined the balance sheet of X Company as of December 31, 19..., and the related statement(s) of income and surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

"In our opinion, the accompanying balance sheet and statement(s) of income and surplus present fairly the financial position of X Company at December 31, 19.., and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

In December, 1947, a controversy began within the profession, following the publication of a tentative Statement No. 23, entitled, Clarification of Accountant's Report When Opinion is Omitted. As a result of various written and oral expressions by the membership, this statement was carefully considered and then issued in final form as adopted at the annual meeting of the Institute in November, 1949.

Auditing Procedure Statement No. 23 (Revised)

This Statement was issued in December, 1949. Its purpose has been misunderstood by many, and its provisions have been ignored by others. For instance, The New York State Society of Certified Public Accountants, the largest state society in the country, has not yet asked its members to follow the rules set forth in this bulletin, and many members have displayed no intention of following it.

Despite all that has been published in the *Journal of Accountancy* and in *The New York Certified Public Accountant* on this subject, it may be well to again explain the purpose of Statement No. 23, and how its provisions may be carried out.

The theory which gave rise to this bulletin is not new or novel, it was contained in the "Extensions of Auditing Procedure" approved in September, 1939, which included the following paragraph:

"The independent certified public accountant should not express the opinion that financial statements present fairly the position of the company and the results of its operations, in conformity with generally accepted accounting principles, when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary. In such circumstances, the independent certified public accountant should limit his report to a statement of his findings and, if appropriate, his reasons for omitting an expression of opinion."

Statement 23 merely substitutes for, and amplifies, the words "if appropriate" in the last sentence above, by stating that

"the independent certified public accountant should state that he is not in a position to express an opinion on the financial statements taken as a whole and should indicate clearly his reasons therefor."

The bulletin then states that

"The purpose of these assertions by the accountant is to indicate clearly the degree of responsibility he is taking."

The major tenet of Statement 23 is expressed in paragraph 4 thereof, as follows:

"Since the accountant cannot effectively control the use to which financial statements accompanied by his name may be put, the adoption of practices which will minimize the possibilities of uncertainties and misinterpretations by third parties is obviously to the interest of all concerned and should aid in the avoidance of embarrassment and damage to the profession. The committee on auditing procedure, therefore, recommends that, whenever financial statements appear on the stationery or in a report of an independent certified public accountant, there should be a clear-cut indication of the character of the examination, if any, made by the accountant in relation to the statements, and either an expression of opinion regarding the state-

ments, taken as a whole, or an assertion to the effect that such an opinion cannot be expressed. When the accountant is unable to express an over-all opinion, the reasons therefor should be stated."

This statement deals mainly with signed reports, but this quotation from paragraph 6 should be of interest in connection with monthly or interim reports:

"When financial statements prepared without audit are presented on the accountant's stationery without comment by the accountant, a warning such as, *Prepared From the Books Without Audit*, appearing prominently on each page of the financial statements, is considered sufficient."

The bulletin further states,

"It is not contemplated that the disclaimer of opinion should assume a standardized form. Any expression which clearly states that an opinion has been withheld and gives the reasons why would be suitable."

Illustrations of Application in Practice

For purposes of a long or short form report accompanying interim financial statements, it is believed that the following closing paragraph complies with Statement 23:

This interim report is submitted for management purposes, and we did not independently verify the assets and liabilities at this date. Therefore, we cannot express an opinion as to the attached financial statements, although they have been prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

A typical application accompanying year-end statements follows:

"Since we did not attend at the physical inventory taking, we are unable to express an opinion as to the financial statements as a whole. However, in all other material respects, it is our opinion that the attached financial statements present fairly the assets and liabilities of XYZ Corporation at December 31, 1949, and the operating results for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

Conclusion

The requirements of Auditing Procedure Statement 23 are desirable. It has been adopted by the members of the American Institute and now becomes one of its rules. It is up to all members of the profession to conform, both as to the form of opinion or denial thereof as well as the underlying audit work.

A Simplified Form of Accountants' Opinion

By Alden C. Smith, C.P.A.

The annual reports for the year 1949 of several corporations contained an accountants' opinion reading somewhat as follows:

"In our opinion, the attached financial statements fairly present the position of A.B.C. Corporation and its subsidiaries at December 31, 1949 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of such statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

This form of opinion is believed to contain all of the essential parts of the present standard form. Regulation S-X, in referring to accountants' certificates, states:

"The accountant's certificate (i) shall contain a reasonably comprehensive statement as to the scope of the audit made including, if with respect to significant items in the financial statements any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission; (ii) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (iii) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case."

Regulation S-X also states:

"The accountant's certificate shall state clearly: (i) the opinion of the accountant in respect of the financial statements covered by the certificate and the accounting principles and practices reflected therein; (ii) the opinion of the accountant as to any changes in accounting principles or practices, or adjustments of the accounts, required to be set forth by rule 3-07; and (iii) the nature of, and the opinion of the accountant as to any significant differences between the accounting principles and practices reflected in the financial statements and those reflected in the accounts after the entry of adjustments for the period under review."

Alden C. Smith, C.P.A., is a Vice President of our Society and Chairman of the Committee on Meetings. He is a member of the American Institute of Accountants and is on the New York State Board of C.P.A. Examiners. Mr. Smith is a partner of Price, Waterhouse & Co.

Since the present standard form of opinion is assumed to fulfill the requirements of S-X as quoted above, it will be obvious from the study of the revised form, that it, too, fulfills such requirements.

This simplified form can be readily adapted to cases where there are qualifications of accounting principles or to the scope of the examinations or exceptions to consistency. The following examples have been taken from annual reports for 1949 and indicate the method in which exceptions can be fitted into the new form:

"In our opinion, except for the possible effect that the matters referred to in Notes A and B may have, the attached statements present fairly the financial position of A.B.C. Corporation at December 31, 1949 and the results of its operations for the year then ended in conformity with generally accepted accounting principles. Except for the changes, which we approve, in the methods of computing interest during construction and depreciation for the year 1949, as set forth in Notes A and B the accounting principles have been applied on a basis consistent with that of the preceding year. Our examination of such statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

"Subject to the adequacy of the reserve for possible additional federal taxes on income referred to in Note A to the financial statements, in our opinion the accompanying balance sheet and statement of profit and loss and earned surplus present fairly

the financial position of A.B.C. Company at December 31, 1949 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. This opinion is based on an examination of the statements made in accordance with generally accepted auditing standards including such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

"In our opinion, the accompanying balance sheet and related statements of income and earned surplus together with the notes thereto fairly present the financial position of A.B.C. Company at December 31, 1949 and the results of its operations for the year then ended, in conformity with the principles of accounting prescribed for electric railways by the Interstate Commerce Commission applied on a basis consistent with that of the preceding year except for the change in the accounting for interest in arrears explained in Note A, which change has our approval. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

"In our opinion, the accompanying consolidated statements present fairly the financial position of A.B.C. Company and its wholly owned subsidiaries at November 30, 1949 and the results of their operations for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of such statements was made in accordance with generally accepted auditing standards except that, in accordance with instructions, we did not obtain confirmation of accounts receivable of the parent company and certain subsidiaries direct from the debtors; however, with respect to these receivables, we have satisfied ourselves by means of other auditing procedures. The examination included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

Initially a question was raised as to whether the simplified form of opinion would be satisfactory to the Securities and Exchange Commission. Since it has been used in registration statements which have been reviewed by the staff of the Commission, it seems reasonable to assume that they have found no objection to it. Also, there have been no questions raised as to its use in certain Form 10-K's filed during the past year.

Discussions with bankers and corporate officials have indicated that they like the directness and simplicity of this form. It is believed that the reader of financial statements is primarily interested in the accountant's opinion, and the new form spotlights exceptions or qualifications in the first sentence. If there is no qualification or exception in the opinion sentence, whether he reads beyond that sentence does not seem to be too important. If, however, the opinion sentence contains a qualification or reference to a succeeding paragraph, the reader is put on notice immediately. Recognizing that it seems to be a characteristic of human nature to read no more than is necessary, the expression of an opinion in the first sentence may tend to lessen the use of the remark, so often heard when the accountants' opinion contained an exception or qualification, "Oh, I never read all of the accountants' opinion."

An Audit of the Affairs of an Insolvent Debtor

By Saul C. Hertz, C.P.A.

The title of this paper is "An Audit of the Affairs of An *Insolvent* Debtor." I used the word "insolvent" instead of "bankrupt" purposefully. At common law, as most of you know, a debtor was insolvent if he was financially embarrassed, even though his assets may have exceeded his liabilties. Nowadays, the definition of insolvency has been narrowed in the minds of many by the National Bankruptcy Act. The act limits the definition to just those cases where the equity section of the balance sheet shows a net deficit. Frequently, however, debtors, who would be *solvent* according to the Bankruptcy Act, find themselves in a financially embarrassed position and require the cooperation of their creditors. Situations of this type were encompassed by the common law definition. Eventually, such debtors' problems are solved by ordinary liquidation, by assignment for the benefit of creditors, by general or limited extensions or arrangements with creditors, by bankruptcy, or by several other methods.

Saul C. Hertz, C.P.A., has been a member of our Society since 1932. He is also a member of the American Institute of Accountants and of the New York Credit Men's Association, and a member of the Committee on Bankruptcy Legislation of that organ. Mr. Hertz is chairman of the Society's Committee on Bankruptcy Procedure. He is a graduate of Pace College and is engaged in practice as a partner of Hertz and Herson, C.P.A's. in New York City and Boston.

This paper was read at a technical meeting of the Society, held under the auspices of the Committee on Bankruptcy Procedure, at the Engineering Societies' Building on May 11, 1950.

Lawyers often say that if a case is well prepared, half the legal battle is won. The prerequisite to a well prepared case is a thorough and well planned investigation. Thus, the accountant selected by creditors to investigate and report on the affairs of an insolvent debtor must have a carefully arranged program before commencement of the audit. The job should be assigned to qualified and, if possible, experienced personnel because, frequently, books and records are received in poor condition, lacking vital facts and figures, which perseverance and skillful application of past experience may reveal. In order to assure undivided attention and energy, the men so selected should also, if feasible, be relieved of other assignments until the report to creditors is submitted. The work must be done expeditiously, accurately, and thoroughly, with the view that the accountant will be called upon to act as a witness in court or appear at a creditors meeting. The audience at such a meeting or in court is generally very inquisitive and impatient. The creditors are usually in an unhappy frame of mind. That being the case, you will find yourselves targets for sharp and well directed queries. Proper preparation, therefore, is essential as a reasonable safeguard against any possible embarrassment.

Audit notes, working papers and schedules supporting your report should be on hand and properly arranged for quick reference. A thorough knowledge of the contents of your report and papers will avoid undue delay. The accountant who is alert and well prepared in anticipation of the various points that will be raised by creditors or counsel, will conduct himself before

creditors or in court with confidence and conviction, and add weight to his opinions and recommendations.

Then again, such ample preparation, the kind of report it yields, and your general conduct and poise before a meeting will be recalled subsequently. The accounting firms who have attained recognition in this branch of the profession may well owe their success to the manner in which they have rendered their reports and given testimony in the past.

An Orderly Approach to the Audit

What should you do on your first visit to the premises of the debtor?

1. *Make a complete inventory of all books, records and documents.*
2. *Make an actual inventory of all the fixed assets, including machinery, equipment, furniture and fixtures.* Some reliable person may be appointed by representatives of the creditors to do this work, obviating the need for the accountant to make the listing, but he should be sure to get the schedule in a very comprehensive form. Before the accountant has proceeded with the audit, it frequently occurs that machinery, fixtures and equipment as well as merchandise are removed from the premises by representatives of the creditors and, consequently, having such a schedule on hand will enable the accountant to verify the items eventually disposed of by such representatives of creditors.
3. *Make an actual physical inventory of all merchandise.* This may be made under your supervision or by other representatives of the creditors. These inventories will serve as the nucleus for your subsequent audit procedure. In the event that further investigation reveals certain discrepancies in the inventory, or concealments of merchandise, this schedule may become an important exhibit to be used as evidence.
4. *Prepare a tentative report consisting of required exhibits and schedules from books and records before audit.* This is advisable in order to satisfy anxious and inquiring creditors. Furthermore, creditors may meet and select a committee, or hear the representative of the debtor propose certain plans. For that purpose, if the debtor has not already prepared a statement for such a meeting, and the accountant already has been selected by some of the larger creditors, he will be expected to have such a tentative report in readiness. While a report prepared without audit may appease some of the creditors, and I use the term "appease" figuratively, I do not recommend its general use, because of its incompleteness and the lack of thoroughness and other professional qualities which such haste encourages.
5. *It would be wise to make several copies of this report for distribution* if a tentative report is expedient, so that creditors will easily follow the figures and have something tangible after they leave the meeting.
6. *Circularize accounts receivable and payable as well as loan creditors, attorneys, insurance agents, banks, tax departments, other debtors and creditors.* Personally call on large creditors and attorneys for inspection of their files.

In proceeding with the actual audit, the following should be borne in mind:

1. Is there any evidence of fraud?
2. What is the present financial condition of the debtor?
3. What was the cause of the failure?
4. With respect to questions that may be asked by creditors:

   a. Was a false financial statement issued, on which the creditors relied in establishing credit?

   b. Are all assets accounted for

and liabilities clearly determined? Are there any fraudulent claims?

c. What are the administrative expenses?

d. What may creditors expect in liquidation, after all expenses of administration are met?

e. In the event a debtor desires to remain in business under an extension, under what conditions does he expect to operate and how will he finance his operations?

f. Have any creditors received a preference?

In spite of all that has been said about fraud in bankruptcy, most insolvencies today are honest. Thus, the accountant has a dual responsibility. His function is not only to discover fraud, but also to assist in enriching the estate by the guidance he offers the creditors or the debtor in its administration, so that they may decide on the best course to pursue. Under these conditions, the accountant may have the opportunity and, if it presents itself, may be expected and called on to do the following:

1. *Discover honestly hidden assets, (of which the following are some illustrations) which may augment the estate.*

a. *Pending law suits.* As an illustration of this point, we recently had a situation in which the assets available for distribution to creditors had a realizable value amounting to approximately $.15 on the dollar. However, during the course of our audit, we discovered some correspondence that had taken place about two years prior to the date of our audit which revealed that a law suit had been instituted by another corporation, which was a wholly owned subsidiary of the insolvent debtor corporation. The subsidiary in other respects was entirely defunct, and the attorney representing the plaintiff was no longer the attorney for other matters affecting the corporation. This suit has not been completed as yet, but it was estimated that it would add at least $.20 on the dollar to the funds available for distribution to creditors.

b. *Possible tax refunds and carry-back claims.*

c. *Insurance premium refunds.* It is definitely recommended that the auditor visit offices of insurance agents and thoroughly check premium refunds that may be available. These sums might amount to substantial figures.

d. *Valuable leases.* Where a lease for premises still had time to run at the time of a creditors' meeting and, where the debtor was simply liquidating his business under supervision of creditors without any formal assignments or petitions in bankruptcy, creditors were able to obtain a substantial amount of money by offering the lease for sale, rather than by abandoning the premises—as the owner of the property would have preferred.

e. *Withdrawals in the form of loans or capital that may have recovery value.* In another matter, careful scrutiny of the accounts revealed that loans were ostensibly made by officers of the corporation, but actually turned out to be withdrawals of capital. In this case, the capital was actually borrowed money and, when the debtors realized their predicament, they withdrew checks payable to themselves, but the endorsements on the checks revealed that the money was turned over to other individuals. Such individuals, in this case, were people of substantial means from whom these monies could be recovered.

f. *Hypothecated assets,* such as accounts receivable, merchandise, fixed assets, etc. In numerous instances, assets have been freed of liens where the liens were defective, and general creditors were enabled to obtain much larger dividends because of these discoveries. During the course of another audit, we had

occasion to examine a factoring agreement which, among other things, provided that the factor had a lien on all merchandise on the premises except that the contract specifically described the location where the merchandise would be kept. In compliance with the agreement, the debtor had constructed a wire cage, and all merchandise within that cage was subject to the lien of the factor. The factor also maintained a custodian on the premises. After several years of operations under this plan, however, the company needed more space for inventory and built a shed outside the building where merchandise overflow was stored. Since the lien did not apply to merchandise outside the cage, there was some question as to whether the factor had a valid lien on this merchandise. The matter was brought to the attention of the attorneys for the creditors. This matter was never litigated and, therefore, I do not know what the outcome would have been. Instead, a settlement was made with the attorneys for the factor, which also resulted in a substantial increase in assets available for distribution to the creditors.

g. *Patents, copyrights and trademarks.* Oftentimes, such assets are not carried on the books of the debtor, but further investigation may reveal a cash value in liquidation.

h. *Life insurance policies owned by the company.* Such assets will not appear on the books and records if annual premiums have been charged to expense without additional entries setting up the cash surrender value.

i. *Commitments which have residual value,* as commitments for purchase of merchandise in a rising market.

2. *To counsel creditors by means of a forecast of operatons, should they grant the debtor an extension.* Such forecasts should be prepared as to operations and finances. Creditors and honest debtors have more to gain if a business can be restored and rehabilitated, instead of being liquidated through the channels of bankruptcy.

Apropos of the foregoing, the accountant may also be requested to act as a business adviser. Of course, there are certain limitations but, in my opinion, there is no one individual who is in a better position, or better qualified, to formulate plans for the successful operation of a business and the correction of its weaknesses than the accountant. However, one must be on guard against optimistic assumptions. Ample qualifications should be made, thereby affording the debtor an opportunity to exceed the predetermined figures rather than to fail in meeting them.

3. *All claims by creditors should be carefully checked and investigated.* New creditors may unexpectedly arise and old claims may not have been correctly recorded. It is not sufficient merely to get the listing from the books. Written confirmation with each creditor should be supplemented by consultations with the debtor or his employees.

It has been said that there was a time when corruption by dishonest debtors was rampant and bankruptcy was a juicy and flagrant racket. In those days, accountants were seldom, if ever, retained. These conditions have been pretty well abolished through the efforts of business men in general, through their trade associations, and particularly through such organizations as the New York Credit Men's Association and other credit groups.

Along with the reform in bankruptcy legislation and procedure, we also find the presence of high-grade, competent lawyers working in cooperation with capable certified public accountants. Accountants, therefore, have found a

(Continued on page 608)

Case Studies in Labor-Management Relations

Sponsored by THE COMMITTEE ON LABOR-MANAGEMENT RELATIONS

SEVERAL years ago the New York State Society of Certified Public Accountants appointed a special committee to inquire into the role played by public accountants in matters dealing with relations between employers and employees. As part of its assignment the committee requested information from a number of New York accounting firms as to what each had been and was doing in this respect.

Much has been written in recent years by representatives both of labor and management as to the importance of factual data—reliable figures of costs, profits, etc.—in wage negotiations. Much has also been written as to the aid that may be rendered by the certified public accountant in the preparation of such data in an independent unbiased manner. These numerous papers, however, have contained very little information as to the type of services that have been rendered by public accountants in actual disputes.

Most accounting firms have at one time or another assisted in the preparation of payroll and wage incentive systems and many have prepared data for the use of management in wage negotiations. On occasion, practitioners have been asked as individuals to arbitrate disputes. However, the recorded cases in which public accountants have been called upon to prove or disprove allegations in disputes have been few.

Therefore, the committee believes that details of several such instances that came to their attention during their inquiries should prove interesting to accountants generally. Three New York firms who reported such instances kindly agreed to supply the committee with the details which are reproduced herewith.

A Dispute As to the Profitability of Certain Operations

Company X was engaged in the production and distribution to retail outlets of three related perishable consumer goods. The company employed a route delivery system, using company owned trucks; the route drivers also acted as salesmen and were paid a base wage, plus commission.

Based on reports of its accounting department, management decided that certain routes operating at a loss should be discontinued and the employment of the drivers terminated. The representative of the local chapter of a national union, of which the drivers were members, contested the proposed action, maintaining that the company's operational data were not accurate.

An arbitrator, agreeable to both parties, was selected. It was evident that no fair solution could be reached without careful examination of the facts. Therefore, in accordance with an agreement between the company and the union, the arbitrator appointed a firm of certified public accountants, not previously retained by the employer or the union, to determine independently the accuracy of the figures presented by the company concerning the profit or loss sustained in the operation of the routes. It was to be the responsibility of the accountants to determine, first, whether the accounting methods employed by the company in the distribution of expenses to the routes were reasonable, fair, and equitable (the opinion, if in the affirmative, not necessarily excluding all possible alternative methods as inequitable) and, second, to set forth the results of operations of the particular routes in question, hereafter referred to as X Routes.

The Accountants' Examination: The accountants did not make a detailed examination of all transactions, but through tests of the accounting methods and examination of supporting data, arrived at what they considered to be a fair opinion as to the reasonableness of the company's accounting.

A current four-week period was selected as the basis for test. The scope of the accountants' examination and pertinent data regarding the system are reviewed briefly in the discussion following.

Sales: The agreement of the total of the detailed sales records with the general books was checked, the distribution to routes of sales shown on drivers' reports was tested, as was the classification of sales as among the three products.

Sales Returns and Discounts: Generally the same procedures were followed as outlined with respect to sales.

Cost of Sales: On the statement of results of operations of X Routes, cost of sales was computed as a percentage of gross sales, a different percentage being applied for each product classification. The cost percentages applicable to each product classification and division of the business were calculated by applying product costs, based upon material formulae and observed labor operations, to the sales of the respective products. Shop labor and plant overhead which could not be allocated directly to specific products were incorporated in the total product costs as a percentage of sales. It was not practicable to check the construction of the various material formulae and labor schedules. To do this would have necessitated attendance at the plant during a considerable period of operations. However, the methods used in constructing the formula costs were reviewed and satisfaction obtained as to the consistency of the methods and application of the principles involved. The cost percentages which were developed from the formula costs were applied to the total of the company's sales in the various product classifications and divisions of the business. The total cost so computed was compared with the total cost of sales per the general books. In connection with the various costs of raw materials, direct shop labor and plant overhead, a number of representative entries in the accounts were traced to the original evidences of transactions.

Salesmen's Salaries: The actual salaries and commissions paid to the salesmen on the routes under consideration were used for the four-week test period.

Automotive Expenses: Those expenses which could be charged direct to the trucks used on the routes were so allocated. Other items, representing service, miscellaneous materials, clerical work, and supervision, were computed by dividing the total amount expended in these classifications by the total number of trucks stored.

The accounts in the general books with respect to automotive expenses were supported by detail records for each vehicle maintained at the garage. A number of transactions in the various expense classifications were traced to original documents to test the accuracy of the distributions.

Other Selling, General and Administrative Expenses: The company applied a percentage of gross sales to provide for these costs in computing the results of operations of routes. The expense classifications were reviewed and a number of representative entries in the accounts were traced to the original evidences of transactions. The sum of the actual selling, general, and administrative expenses was compared to the total gross sales to determine the propriety of the percentage relationship.

Based upon their examination of the books and records of the company, reviewed briefly above, the accountants were able to render an independent opinion as to the equitableness of the accounting methods followed by the company in distributing costs to the various routes and were able to render a statement of operations for X Routes for the four-week test period.

The arbitrator used this independent report, prepared by a disinterested third party, as the basis for settlement of the dispute.

A Dispute As to the Cost of Living in Various Cities

In February, 1947, Company A had for some time been negotiating with the labor union locals representing its employees in respect of a demand for an increase in wages. The negotiations had been unsuccessful and application had been made to the National Labor Relations Board to submit the dispute to arbitration.

The main point of disagreement centered about the determination of the difference between the increase in the Cost of Living Index and the increase in the average straight-time hourly rate of pay between January 15, 1941 (the date set by the "Little Steel Formula" as the base point against which such increase should be measured) and April 1, 1946.

The determination of the increase in the Cost of Living Index was relatively simple since both parties agreed to recognize the Consumers' Price Index figures compiled by U. S. Department of Labor, Bureau of Labor Statistics. The only point which remained to be agreed upon was the selection of cities, or sections of the country, price indexes for which were to be used as units of measure.

The more controversial matter was the determination of the increase in the rate of pay between January 15, 1941 and April 1, 1946. The certified public accountants regularly retained by the employer were asked to make this determination showing the average hourly rate at January 15, 1941, the average hourly rate after each "general" increase in rate of pay during the period January 15, 1941 and April 1, 1946, and the average hourly rate of pay at April 1, 1946. The determination of what constituted an increase in rate of pay for this purpose had to be made along the principles laid down for the "Little Steel" formula.

The work was somewhat complicated by the reason that in arriving at the average hourly rate of pay at the different dates the accountants had to take into consideration, and give effect to, the change in the composition of the Company's payrolls as a result of major sales and purchase by the Company of operating units and properties during the period under review.

Upon completion of the examination, the accountants reported their findings to the Company in writing. The Company submitted the report as one of its exhibits to the Arbitration unit and during the hearings the accountants were called upon to testify as to the nature and extent of the examination and as to the figures contained in the report.

The increase in the hourly rate eventually awarded by the Arbitration unit was equivalent to the approximate difference between the increase in the Consumers' Price Index from January 15, 1941, to April 1, 1946, and the increase as determined by the accountants, in the average hourly rate of pay between those dates.

A Dispute As to the Determination of a Group Incentive Bonus

The B company was engaged in manufacturing several models of an intricate piece of machinery, the various parts for which passed through numerous departments before final assembly.

All factory wages were governed by a union contract which, among other things, provided for a group incentive bonus. The union questioned the bonus paid employees of certain departments and had four of its members make an examination of the company's payroll records for a period of one week. In the week selected for test the union contended that the company had failed to include or allow 80,000 earned minutes in the bonus computation and claimed a like number of earned minutes for each of the thirty preceding weeks. The amount involved was substantial. The company advised the union that it would arrange for an examination of its payroll records by a firm of independent public accountants. After reviewing the union contract, the method of computing the bonus, the company's

payroll procedures and the system of internal accounting control, the accountants decided that their next step would be to check the payroll and bonus records for the same week tested by the union and compare their findings with those of the union.

The group incentive plan, under the terms of which the bonus was computed, called for the fixing of time standards stated in terms of minutes required to carry out one or a group of operations resulting in one good part produced (earned minutes). The group efficiency was measured in terms of a percentage arrived at by dividing the total minutes earned by the group by the actual minutes worked by the group. In computing the group efficiency, earned minutes were adjusted for work done on new operations for which time standards had not been fixed, etc.

Punched card accounting was used for all payroll records. Clock cards were matched with prepunched daily cards which were tabulated and filed until the end of the week when a summary card was punched. The summary cards, from which were prepared the payroll register, payroll checks and check register, were tabulated and the total hours worked were compared with the weekly clock card on which the daily hours had been extended.

When assigned work employees were given job cards showing time work started and standard time per unit. The hours worked (elapsed hours) and the number of units completed were entered on the card subsequently. Elapsed hours were compared daily with the tabulation of the clock card hours. Total earned minutes as shown by a tabulation of the job cards served as the basis for the bonus computation.

When time standards had not been set for operations special forms in addition to the job cards were prepared. Temporarily the elapsed minutes were also used as the earned minutes but subsequently the special forms were evaluated by the time standards department and any additional earned minutes allowed were included in the bonus computation. Frequently the time standards department could not complete its evaluation work in time to permit the additional earned minutes to be included in the same bonus computation as that in which the elapsed minutes were included.

The accountants first checked to see that for each man on each day of the week there were job cards with elapsed hours which agreed with the daily payroll record. Certain job cards were found to be missing. Each job card was then inspected to see that a unit time standard was shown on it. If none appeared, there was a presumption that additional earned minutes were to be allowed on one of the special forms. In reviewing the special forms for the week tested, earned minutes allowed for work done several weeks previously were found. Therefore where allowances could not be found in the week under review for job cards which did not show time standards, subsequent week's papers were reviewed. In doing the foregoing work particular attention was given to the items mentioned in the union report and special efforts made to account for the earned minutes claimed to have been lost.

Upon completion of the foregoing work the accountants reported to the company that in their opinion the claims set forth in the union report were overstated to the extent of x% of the total earned minutes claimed, an additional y% of the earned minutes claimed appeared to be questionable and z% might represent a valid claim. On the basis of the accountants' report the company and the Union were able to reach a mutually satisfactory settlement.

Committee on Labor-Management Relations

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Following the New Wage and Hour Regulations

By John F. Parnaby, C.P.A.

It is my privilege today to speak to you briefly concerning the new Wage and Hour Regulations. These regulations do not present any problems which are basically new. What they do is essentially to re-emphasize a problem which has long been with us—the problem of rising staff costs. And this problem, as we all know only too well, is aggravated by the fact that most of us have to contend with a peak period of perhaps three or four months, during which exceptionally heavy demands are made upon our staffs, followed by a relatively slack period for the balance of the year.

With some of us this peak period is less pronounced—some of us have been better able to rearrange the timing of our work so as to spread it more evenly over the year—but all of us, I think, in greater or less degree, face the annual problem of which the inevitable result is that we have to resort to the use of temporary additional staff and, even then, excessive hours are often unavoidable.

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In these circumstances, the first and most important decision an employer has to make, in complying with the Wage and Hour Regulations, lies in the selection of a suitable wage plan.

The basic requirements of any wage plan, as you all know, are a 75-cent minimum hourly wage and the payment of overtime at one and one-half times the regular rate of pay.

Of course, it would be logical for us to seek first for some permissible basis which would enable us to offset excessive hours worked in our busy season against idle hours for which time off could be given at some other period during the year. Unfortunately, a direct offset of hours is not permissible under the Wage and Hour Regulations, which specifically require the overtime payable to be computed in dollars on the basis of each work-week as a separate and distinct period.

However, there are two wage plans which, if adopted in appropriate circumstances, offer the possibility that excessive hours worked during limited periods need not necessarily mean additional wage costs. They are known as the Time-Off Plan and the Pre-Payment Plan.

In order to use either of these plans, the employer must first make sure that he is under no obligation to pay a full week's salary to his employee, if less than a full week's time is worked. So that, for all practical purposes, he has to engage the employee, not on a salary, but on an hourly basis. Neither of these plans can change the requirement that overtime has to be figured on the basis of each separate work-week.

Time-off Plan

The Time-Off Plan operates only where the pay-period includes more than one work-week and it enables the employer, if overtime is payable for any work-week, to lay off the employee for part of the other work-weeks within the same pay-period and thus partially or wholly offset the extra wage cost of the over-time week.

The important point to keep in mind in assessing the possible advantages of this plan is that normally a pay-period cannot exceed one month. Consequently, if the plan is to be of any practical benefit to the employer, each month in which over-time is worked must include also a sufficient amount of idle time to enable the employee to be given one and one-half hours off for each hour of overtime worked. If these conditions exist, the Time-Off Plan can definitely be advantageous, but it seems to me that the number of occasions where its adoption would be appropriate will be very limited.

Pre-Payment Plan

The Pre-Payment Plan unquestionably provides the nearest approach to the offsetting of idle hours in a slack period against overtime in the busy season.

Since actual offsetting of hours is not permissible under the Regulations, this plan is formulated on the theory that an employer during the slack period may pay an employee a regular amount representing forty hours weekly work at regular rate, even though the employee has worked less than forty hours weekly. The excess of the amounts paid to the employee over the actual hours worked, at regular rate, is recorded as an advance against future salary; that is, as a loan to the employee to be worked off at a later date by overtime.

When the busy season arrives and the employee works in excess of forty hours weekly, his overtime will not be paid to him in cash, but will be withheld by the employer and applied in reduction of the salary advances which have been built up during the slack period. Only when these advances have been completely offset by earned overtime will the employee be entitled to receive his overtime earnings in cash.

Applied in appropriate circumstances, the Pre-Payment Plan offers to an employer very material savings in the cost of overtime. Moreover, these savings may well be the deciding factor in determining whether the employer can afford to retain the services of an employee on a permanent basis, so that the plan may well be advantageous also to the employee.

However, a word of warning is necessary. The validity of this plan is dependent entirely on a full understanding by the employee that in those weeks when his hours worked are less than forty, the money in his pay envelope represents in part an advance from his employer.

It is not enough that both employer and employee expect or anticipate that the advance will be worked off by overtime. There must exist a clear understanding between them that if overtime should be insufficient to work off the advance, then the balance will be refunded by the employee in cash.

I would strongly recommend to any employer who contemplates using the Pre-Payment Plan that he have a written agreement to this effect with each employee concerned, for the very practical reason that the question of refunding any balance of salary advances under the plan is most likely to occur when or if the employee's employment is terminated.

If the employer's records show that the balance of advances was not refunded at that time, it is more than likely, on the basis of specific experience, that the plan will be held to have been invalid from the start so far as the employer is concerned; and in this event payment of *all* overtime in cash would be required.

An employer adopting the Pre-Payment Plan would probably be wise also, to provide in his agreement with the employee, for settlement in cash of any salary advances not worked off by overtime at some specific date in each year. The Regulations are not entirely clear as to whether an annual settlement is required but, in Interpretative Bulletin No. 4, reference is made to an annual settlement and it might therefore be argued that the Regulations presuppose one.

These two wage plans, the Time-Off Plan and the Pre-Payment Plan, are the only recognized plans which specifically afford the employer the possibility of working his staff overtime without thereby incurring additional out-of-pocket cost. You will observe that the Pre-Payment Plan is particularly suited to a case where there are sufficient completely slack periods durthe year to permit giving employees time off without interfering with the necessary work of the office.

For those of us who find that overtime during the year-end season is unavoidable, yet do not have a sufficiently slack period to enable us to use the Pre-Payment Plan advantageously, there are two other wage plans which are worthy of consideration. These are known as the Belo-Type Plan and the Irregular Work-Week Plan.

Belo-Type Plan

The Belo-Type Plan is one which has received a good deal of publicity. It has been passed upon and approved in principle by the Supreme Court. Its benefit to the employer is derived from the fact that, within the permitted limits, it reduces overtime costs by allowing the regular rate of pay (on which overtime is based) to be fixed at a lower figure than would be arrived at by dividing the weekly salary by forty hours.

The prerequisites for this plan are, first, fluctuating weekly hours; second, a guaranteed minimum wage; and third, an agreed hourly rate of pay. These three essentials must be a matter of clear agreement between employer and employee.

The operation of a Belo-Type Plan is probably best illustrated by an example. In adopting the plan, the guaranteed minimum weekly wage and the probable average number of hours the employee will be required to work should first be determined. Let us suppose a minimum of $55 per week is agreed upon, with average weekly hours of 50.

The applicable regular rate would then be $1.00 per hour, this being the rate which, for 50 hours, with time and one-half for the 10 hours in excess of 40, would produce the minimum $55 weekly wage. You will notice that, except for the operation of this plan, the regular rate based on 40 hours at $55 weekly would be $1.37½.

The employee will receive a minimum of $55 per week under the guaranteed minimum wage provision even if he works less than forty hours and in any work-week in which he works up to, but not exceeding, 50 hours he will still get the same $55. Only if he works in excess of 50 hours in any work-week will he receive more than $55—then he will receive $1.50 for each hour over 50.

Although it has been ruled that this type of plan meets the requirements of the Wage and Hour Regulations, an employer would do well to think carefully before adopting it. The point of uncertainty lies in the number of hours which is taken as the average. Average hours of more than sixty will definitely invalidate the plan, but it is entirely probable that the validity of the plan would be questioned in any instance where subsequent experience showed that the actual average hours worked were appreciably below the number used in calculating the regular rate of pay.

Irregular Work-Week Plan

The Irregular Work-Week Plan is likely to be advantageous in circumstances where the hours worked in each

week fluctuate and particularly where it is difficult to tell in advance just how many hours of work will be needed to accomplish the job which has to be done. I would think that these circumstances must prevail in the offices of many among us.

This plan is premised on the assumption that the employee is paid a weekly salary with the understanding that such salary represents his straight-time pay for all hours worked in the work-week, regardless of what the actual number of hours may be. The regular rate of pay will therefore not be a constant figure, but will be computed for any given week by dividing the actual number of hours worked into the weekly salary.

To comply with the Wage and Hour Regulations, in any work-week in which more than forty hours are worked, the employer will pay, in addition to the regular salary, an amount equal to one-half of the regular rate for that week, for each hour in excess of forty.

However, if this plan is adopted, the employer must keep constantly in mind the minimum wage provision of the Act. If an employee receiving $40 a week worked (say) 60 hours in a work-week, his regular rate under this plan would be calculated for that week as 66⅔ cents per hour, but the minimum hourly rate of 75 cents would then take effect and the employee would be entitled to receive for that week 40 hours at 75 cents, plus 20 hours at $1.12½ cents—a total of $52.50.

I have discussed these four wage plans in detail because, in my opinion, they are the plans most likely to be suitable for a professional employer.

There is, of course, nothing whatever to prevent an employer from devising a plan of his own so long as it meets with the basic requirements of a 75 cent minimum hourly wage and provides for the payment of overtime at one and one-half times the regular rate of pay. However, before adopting any plan other than those which are already generally recognized, an employer would be wise to check with the office of the Wage and Hour Administrator to make sure the plan is acceptable.

I have referred to the selection of a suitable wage plan as the most important decision to make in complying with the Wage and Hour Regulations. So, let us assume we have chosen a plan that we know is acceptable.

It remains for us to apply it properly and keep adequate records available to show that we have done so. We shall then be in full compliance with the Wage and Hour Regulations. Unfortunately, for a professional employer, this is not so easy as it sounds.

Exempt Employees

The difficulty lies in deciding which of our employees are exempt from the Wage and Hour Regulations and which are not. The basic rule is that employees who are employed in a bona-fide professional capacity are exempt, but this, as we all know, does not mean that because the employer is himself a professional man, his employees are exempt. On the contrary, the regulations specifically provide that any employee receiving less than $75 weekly is definitely not entitled to exemption under the rule. They provide further that, even if the employee is receiving more than $75 weekly, he is exempt only if his work meets certain defined requirements.

It would serve no good purpose to discuss these requirements in detail. The significant point is that there is no widely accepted understanding of them, so that their interpretation is largely a matter of viewpoint and opinion.

It is probable therefore that a professional employer will consider that the duties of those of his employees who are receiving over $75 weekly entitle them to exemption under the regulations. And it is equally probable, judging from the experience of a number of us, that the Wage Administrator may consider some of those employees to be non-exempt.

I do not know how many of you have been visited by an investigator from the Office of the Wage Administrator. But for the benefit of those of you who have not yet had that experience, let me say that it is the regular practice of the investigator not only to examine the payroll and time records, but also to interrogate selected employees concerning the detailed nature of their work. Largely on the basis of information so obtained the investigator will form his own opinion as to whether the employee is or is not exempt.

To summarize therefore, a professional employer, to be in compliance with the regulations must, as a minimum, apply an accepted wage plan to all of his employees who receive less than $75 weekly and to any of his employees receiving more than that salary, unless he is prepared to justify their exemption on the ground that their duties entitle them to exemption under the applicable definition.

And he must recognize also that, as the regulations now stand, there is always the risk that employees whom he has considered exempt may later be retroactively held to be non-exempt.

Record Keeping

The records which the regulations require to be maintained by the employer present no difficulty. No special form for these records is prescribed, and they have to give no more detail than most of us, I think, would consider necessary for an adequate record of hours worked and wages paid. However, I recommend to any employer that he should check his records with Part 516 of the Regulations which lists the specific requirements.

As you know, we have had Wage and Hour Regulations with us for some twelve years. Over that period they have increased both in length and complexity against a background of actual experience. However, notwithstanding the volume of interpretative information which is currently available from the office of the Wage and Hour Administrator, there still arise from time to time points of uncertainty requiring further clarification.

Traveling Time

Our time this morning is limited, so I propose to discuss only one of these doubtful matters—the question of hours spent in traveling. For convenience, let us divide the subject into local travel and out-of-town travel, respectively.

With respect to local travel, it is well established that the time spent by an employee in traveling from his place of residence to his employer's place of business does not constitute hours worked.

However, a minor complication arises where, as in the case of professional accounting staff, the employees more frequently go directly to the office of a client instead of to the office of the employer. The employer's office may be, let us assume, one hour's traveling time away from the employee's residence. Yet the employee may go directly to the office of Client A, to reach which he travels for only one half-hour, or he may go directly to the office of Client B, which takes him two hours to reach.

The question is, to what extent, if at all, in these varying circumstances, does traveling time constitute hours worked for which the employee should be paid.

I do not know the answer; but there seem to me to be two alternative viewpoints, either of which may be correct in the appropriate circumstances.

Firstly, in circumstances where it has been made clear to the employee at the time of his engagement that his normal hours of work will coincide with those of the various clients on whose work he is from time to time engaged, it would seem reasonable for the employer to take the position that the client's local office is, for all practical purposes, synonymous with the office of the employer and that accordingly none of the time spent by the employee in traveling

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Fund Accounting—A Plea for Increased Study

By Robert G. Allyn, C.P.A.

Accounting teachers should consider the possibility that there are tendencies in the economic world which might call for a reconsideration of the ultimate objectives of accounting. At least, the instructors in the theory of accounting should consider adding to the present objectives, if not revising them entirely. In a business community dominated mainly by a profit-making goal, students of accounting can reasonably believe that the reason for the comparison of the net worth of an enterprise at the end of a fiscal year with its net worth at the beginning is to determine whether a profit has been made; and the reason for comparing income with expense is to ascertain how that profit was made, or whether the increase in net worth was a capital change.[1] However, it might be worthwhile to observe the effects of the widening pools of socialized and nonprofit enterprises on the capitalistic continent. The growth of labor unions in terms of accumulation of wealth and financial activities, the increasing adoptions of pension funds and profit-sharing plans, and the operation by governmental corporations of business enterprise are some examples of the reason why accounting as it is taught today may be found to be inadequate for the future. It is suggested, therefore, that accountability and responsibility be given more emphasis as objectives in the study of accounting. This will partially be accomplished by promoting the study of the principles and practices of Fund Accounting.

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The essence of Fund Accounting is stewardship. A Fund, as defined by the National Committee on Municipal Accounting is, "a sum of money or other resources set aside for the purpose of carrying on specific activities, or attaining certain objectives in accordance with special regulations, restrictions, or limitations".[2] Fund Accounting is similar to what we might call Commercial Accounting, by way of contrast, in that it is based on the rules of debit and credit, and generally follows the features of double-entry bookkeeping. It makes use of the same styles of journals and ledgers as do all accounting systems. Its essential characteristic, however, lies in the identification of certain accounts with a specific fund, the nature of which determines the scope of the activities of those accounts.

A rough analogy might be drawn by using the example of a man with two sources of income[3] and two bank ac-

[1] Pages 3-4, Rosenkampff and Wider, *The Theory of Accounts* (Rev. Ed.) Ronald Press Company; New York, 1942. See also Kozmetsky, George, *Financial Reports of Labor Unions;* Harvard University, 1950. On page 149, Mr. Kozmetsky comments that "Fund Accounting is used extensively by Unions."

[2] Page 11, *Municipal Accounting Statements*, Bulletin #6, National Committee on Municipal Accounting; Chicago, Illinois, 1936.

[3] In Fund Accounting, the proper term is "revenue", which is defined as "additions to cash or other current assets which do not increase any liability or reserve, nor represent the recovery of an expenditure." Page 150, *Municipal Accounting Statements.* The term "revenue" in Fund Accounting does not connote the same ideas as the term "income" does in Commercial Accounting. For a discussion of the difference in the current usage of these two words, see Rosenkampff and Wider, *op. cit.*, pages 49-50.

counts. All of his income is deposited in one or the other of the bank accounts determined by the restriction he has placed on the use of these funds. All deposits, then, and all withdrawals are made only for the specific purposes for which the bank accounts were set up—as, for example—one bank account for operating expenses and the other for capital expenditures. In setting up his records, the man treats each bank account as a separate accounting entity. All deposits come from a pre-determined source; all withdrawals are for a pre-determined purpose. The accounting entries maintain the distinction throughout between the two funds, thereby making possible two balance sheets. By super-imposing a budgetary estimate of receipts and expenditures upon the two-fund structure and incorporating the budget figures into the accounting record, the man in our analogy is well on the way toward a fund accounting system such as one might find in a well-regulated municipality.

Inasmuch as most governmental enterprises, with the exception of some publicly-owned and operated utilities, are not operated for profit, they use the accounting tool mainly to report on their custodianship over numerous types of funds. The same may be said of other non-profit institutions, schools, hospitals, labor unions, etc. And to reiterate, the same might be said in the future if and when commercial enterprise should be forced or voluntarily take upon itself the burden of supplementing Federal Social Security with pension funds and the like. If there is some onus on profit-making, as some are inclined to think, the logical result short of an economy based on the philosophy of granting to everyone according to his need without regard to his contribution, is a break-even point economy. Of course, promotion of efficiency and economy through cost control would still be a paramount objective, but the reduced emphasis placed upon accounting for profits with the consequent resurgence of the balance sheet into prime importance might cast the balance sheet into a mold different from its customary pattern of today.

Even though such extremes, as envisioned above, do not come to pass, we are still faced with the present fact that there is a growing need for students of accounting, and quite probably, all students of commerce who understand the principles and are somewhat familiar with the practice of Fund Accounting. For that matter, one might go further and say that every student should have a knowledge of accounting, whether it is accounting of one variety or another. The complexities of life both at home and at work virtually require the sort of regimen that accounting provides.

Likewise, the students of the social sciences, particularly the political scientists, are finding it increasingly desirable to understand the accounting function. The findings of the Hoover Commission,[4] particularly with respect to the shortcoming in accounting for the use of federal funds has brought out even to the casually-interested citizen the fact that if the government is going to efficiently provide for the "greatest good for the greatest numbers" it can do so only by improving its internal organization. This means improving its accounting, especially for government-owned corporations.[5] That political scientists have recognized the value of

[4] Cf. Andrews, T. Coleman, C.P.A. "Hoover Commission Disagrees on Changes in Government Accounting". *Journal of Accountancy*, March, 1949; pages 192-199.

[5] Norris Poulson, C.P.A. "Significance to Accountant of Fundamental Changes in Government", presented at 62nd annual meeting of American Institute of Accountants. Also, H. W. Bordner. "Financial & Accounting Administration in the Federal Government", Volume XXIV, No. 4, *Accounting Review*, October, 1949. Mr. Bordner presents an excellent analysis of Federal Government Accounting. He recommends, moreover, that cost accounting be integrated into the scheme of fiscal accounting because he believes that control of cost through accounting is just as desirable for the government as it is for private enterprise.

accounting as a tool in the analysis of national income measurement has been carefully documented for us by Professor Cooper in the July, 1949, issue of *The Accounting Review* in an article, "Social Accounting: An Invitation to the Accounting Profession." He has criticized the accounting profession for failing to recognize how valuable accounting could be in the understanding of the problems of public finance.

Finally, the growing need for certified public accountants with a knowledge of Fund Accounting theory and practice, has been demonstrated by the frequent incidence of municipal and institutional accounting theory and practice questions on the semi-annual uniform CPA examinations prepared by the American Institute of Accountants.[6] The accounting profession has recognized the widening scope of accounting and has thereby provided evidence of its belief that the professional accountant will be called upon more frequently to lend his technical skill and knowledge to the huge problems of public finance.

[6] Cf. Howard M. Daniels, C.P.A., "How to Write a Successful Answer to a Municipal Accounting Question in C.P.A. Examinations", *The Journal of Accountancy*, page 329; April, 1950. Mr. Daniels cites the result of a survey he has made of municipal accounting questions given in the C.P.A. examination from November, 1939, to November, 1949. He states that at least one fund accounting question has appeared in every examination.

Following the New Wage and Hour Regulations

(Continued from page 603)

between his home and the client's office represents hours worked.

Secondly, in the absence of a clear understanding with the employee on this point (or where established office policy on the subject is lacking) it would be logical to treat as hours worked any time spent by the employee in traveling from his home to his work in excess of the time he would have spent in traveling to his employer's office.

The question of out-of-town travel raises a somewhat different problem. Consider, for example, a staff accountant employed and resident in New York who travels to an engagement in, say, Houston, Texas, leaving New York at 8 o'clock on Sunday evening and arriving in Houston at 11 o'clock on Tuesday morning. He will spend some forty consecutive hours on the train and the question arises as to how much of this time constitutes hours worked.

As a practical matter, an accounting employee on the staff of a professional firm invariably understands quite clearly that it is a part of the conditions of his employment, and one of the exigencies of his profession, that he hold himself available for such out-of-town travel as may reasonably be assigned to him. On the premise that this understanding clearly exists, the traveling time will represent hours worked only to the extent of the normal working hours therein included.

Normal working hours for this purpose mean the regular daily office hours of the employer, except where the employer has adopted the Irregular Work-Week Plan, in which event the regular office hours of the client should apply.

Semi-Public Institutions Under the New York City Sales Tax Law

By MORTIMER LIPSKY, C.P.A.

SECTION N41-2.0 Schedule A (b) of the Administrative Code states,

> "Receipts from sales or services by or to the state or city for governmental or public purposes, receipts from sales or services by or to semi-public institutions . . . shall not be subject to tax hereunder."

The term semi-public institutions is defined by Section N41-1.0 (8) of the Code as

> "those charitable and religious institutions which are supported wholly or in part by public subscriptions or endowment and are not organized or operated for profit."

Article 12 of the Regulations amplifies this definition:

> "Included as semi-public institutions are hospitals (other than private hospitals operated for gain or profit) and religious institutions; also the YMCA, YMHA and public or semi-public educational institutions not organized or operated for profit. No general ruling may be made to indicate what other institutions are exempt from the tax without knowledge of the nature and character of such institutions."

The Regulations[1] go on to limit the definition as follows:

> "Semi-public institutions are not required to pay or collect the tax upon their receipts from purchases, sales or services, used or consumed in connection with the operations of the institutions. They are not exempt from the tax on the receipts from sales or purchases in connection with other property they own and not used for charitable or religious purposes. For example:
>
> "A charitable institution owns and operates an office building, leasing space therein to its tenants from whom it receives rents. If such institution purchases fuel oil, coal, electricity or articles of tangible personal property to be used in said office building, it will be required to pay the sales tax on such purchases to its vendors."

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The law[2] presumes that all transactions are subject to tax until the contrary is established. The burden of proving that the transaction is not taxable rests on the seller or purchaser. The procedure is to apply to the department, giving a full statement of the claim for exemption. The department will issue a letter of exemption if it feels that the institution comes under the definition in the law.

But as one tax service[3] comments, the term semi-public institutions "is not sharply defined." The limiting definition in the Regulations seems to have been sustained in *German Masonic Temple Association* v. *City of New York*.[4] There it was held that an organization operated for profit is not exempt from sales tax even though all of its profits are devoted to the maintenance of an asylum which is purely charitable in character. However, see *Trustees of Sailors' Snug Harbor* v. *McGoldrick*[5] where trustees under a will who operated real estate and devoted the profits thereof to the upkeep of the sailors' home were held exempt from sales taxes.

In other cases, sales in a book store of New York University (*New York*

1 Article 12.
2 Section N41-2.0—Administrative Code.
3 Prentice-Hall New York Tax Service, Volume 3, par. 77,060.
4 279 N.Y. 452 (1939).
5 255 A.D. 64, affirmed 280 N.Y. 537 (1938).

University v. *Taylor*[6]) and the purchases and sales of the YMCA (*YMCA* v. *Taylor*[7]) were held nontaxable.

The Metropolitan Museum of Art, the New York City Bar Association, and the American Cancer Society were ruled semi-public institutions by opinion of the Comptroller.

The trend, if any, has been toward relaxing the rigid definition in the law. It has been held that the legal meaning of charitable purposes is not necessarily limited to free services to the poor.[8] In *Matter of Mendelsohn*[9] the court stated,

> "That fees are charged by a university or hospital is not controlling as to its being a charity, for only when such income is devoted to the profit of the founders and not used to carry on the work by adding to the endowment, etc. does it show the institution is a business and not a charity."

Thus, in the *YMCA* v. *Taylor* case, above, the 31,800 paying members were held to be proper recipients of the plaintiff's services.

An interesting new line in the decisions has tended to extend the meaning of "charitable purposes" so that it will be construed uniformly in the interpretation of all the laws on our statute books. In *Matter of Mendelsohn*, above, the court stated,

> "Use of the words 'charitable purposes' in the Labor Law must be presumed to have been in accordance with their well established meaning."

A similar conclusion was reached in a case concerning the State Labor Relations Law.[10]

Whether this line of reasoning will be extended to the New York City Sales Tax Law, so as to greatly expand the definition of semi-public institutions under that law, remains to be seen.

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6 251 A.D. 444, affirmed 276 N.Y. 620 (1936).
7 159 Misc. 539, affirmed 251 A.D. 821, affirmed 276 N.Y. 619 (1935).
8 *People* v. *Sexton*, 48 N.Y.S. (2nd) 205.
9 262 A.D. 605 (1941).
10 *Trustees of Columbia University* v. *Herzog*, 269 A.D. 24 (1945).

An Audit of the Affairs of an Insolvent Debtor

(Continued from page 594)

very important place in bankruptcy investigation and administration, and the lawyers have done an excellent job in prosecuting and eliminating the dishonest debtor. While this has been very beneficial to creditors as a group, it has also been of tremendous help in aiding honest debtors to rearrange their financial difficulties. Many debtors have found that through the cooperation of competent professional men and sympathetic creditors, they were able to retain their cherished reputations, to pay their debts, get their financial houses in order, and thereafter to succeed in their enterprises.

Death of a Salesman ... or Other Employee

By George Kattenhorn

Until a few years ago the resident accountant usually gave little thought to the release of wages, commissions and other types of remuneration due deceased employees of his firm. However, the following occurrence is but one example of why this attitude has changed:

Within a few days after an employee of a large company passed away, his alleged widow presented herself and asked for her late husband's pay. Up to that time it was customary to pay over the amount due the deceased without questions. After about two weeks had elapsed, a letter from an out-of-state resident was received in which she claimed herself to be the widow, and inquired about any monies that might be due her as said widow. It soon developed that the first claimant who had been paid was not the decedent's wife, and that the second one was the legal widow. An adjustment was finally made and everyone was made happy.

However, serious consequences could have ensued and the incident illustrated vividly the importance of checking the law on the subject. With present high wages, the delay of several days to a week before payment thereof is made (together with earnings for accrued vacations and other benefits) makes it immediately obvious that a substantial sum of money may become payable.

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Mr. Kattenhorn is a past President of the Brooklyn Chapter of the National Association of Cost Accountants, and a member of the Board of Governors of the Accountants' Club of America.

Companies should be careful to pay the proper person or persons. So far as wages, etc., due the deceased employee are concerned, Section 103-a of the New York Decedent Estate Law reads as follows:

> "It shall be lawful for any employer . . . (including without limitation thereon the state or a municipal corporation) at any time not less than thirty days after the death of his or its employee . . ., to pay all wages or personal earnings . . . due to such deceased employee . . . to (1) the surviving husband or wife; (2) children eighteen years of age or older; (3) father or mother; (4) sister or brother, of the deceased employee . . . (preference being given in the order named), without requiring letters testamentary or letters of administration to be issued upon the estate of such deceased employee . . ., where such wages or personal earnings . . . do not exceed the sum of five hundred dollars. The payment of such wages or personal earnings . . . shall be a full discharge and release to the employer . . . from any claim for such wages or personal earnings. . . . As a condition of such payment, such employer . . . may require proof by affidavit as to the parties in interest and may also require a proper receipt or release for such payment."

It should be pointed out that the foregoing section is permissive—not mandatory. In other words, an employer may, if he so desires, refuse to make payment under Section 103-a and insist on the appointment of an executor or administrator. If there is any question as to the propriety of making payment, this would be the absolutely safe course, but in most instances, an employer may safely make payment if he complies with the requirements of Section 103-a.

Under the above section, it is well to remember that the following salient conditions must be carefully met:

1. *Thirty days have elapsed since the death of the employee.*

This is designed to require the passage of sufficient time to allow application to be made for letters, before any disposition is made of any assets of the decedent.

2. *The amount due for wages or personal earnings does not exceed $500.*

Payment cannot be made if the amount due is over $500. For example, if $550 is due, the employer may not pay out $500 and retain the balance. His only safe course is to require that letters testamentary or letters of administration be issued, and then to make payment to the executor or administrator.

3. *Payment can only be made to the persons above-named and in the indicated order.*

This statute does not authorize the employer to pay money to undertakers, creditors of the decedent, or anyone other than the specified persons in the specified order. If payment is to be made to an undertaker, hospital, doctor or nurse, it would be best to make the check payable to the widow, child or other relative, obtain a receipt from such person and let him or her endorse the check over to the party to whom he or she wishes it paid.

If there is only one beneficiary, there is no question but that such beneficiary receives the entire amount due. If, however, there are several persons in the same class, such as three children (eighteen years of age or older), payment should not be made to one, but to all three jointly. The same rule would also apply to sisters and brothers, or when both mother and father survive. The reason is, of course, that everyone of the same degree of kinship has an equal right under the statute.

As a condition precedent to making payment, the employer may require proof by affidavit as to the parties in interest and may require a receipt or release. If there is or may be an executor or administrator, he is entitled to collect the wages in preference to the relatives named.

When a surviving spouse or other relative of the deceased employee makes claim for wages and other remuneration, inquiry should also be made as to whether there is an attorney. If the answer is affirmative, then the matter should be referred to the attorney and handled through him.

Should it come to pass that the surviving spouse or other specified relative reports that a will is in evidence, then no payment should generally be made until the estate has been processed in the Surrogate's Court. Where letters testamentary or letters of administration have been issued, or the amount to be paid is in excess of $500, it is also recommended that a tax waiver be received from the State of New York.

Most widows are greatly perplexed after the passing of their loved ones and every effort should be made to assist them in obtaining other possible benefits. To that end recommendation is also made that they go to the nearest Federal office for benefits, if there are children under 18 years of age, or, if the widow is 65 or over, in connection with Old-age and Survivors Insurance. No attempt should be made to obtain forms or give advice; however, a booklet describing Federal O.A.S.I. benefits should be offered as a further matter of assistance. A supply of these forms, (I.S.C. 35) may be obtained from nearest Federal Security Agency, Social Security Administration office. The forms are usually found to be most helpful. Of course, with the termination and final settlement, the customary W-2 Form, is also released.

Our experience has been that the recipients of help and guidance are greatly appreciative and it becomes a real source of satisfaction to assist those unfortunate families. At the same time you protect your company's interest by guarding against improper payment and possible legal action.

The Sine Qua Non—Good Will

By Thomas W. Byrnes, C.P.A.

The development of a clientele has always puzzled those about to embark on a professional career. Advertising, frowned upon by national and state organizations, has never been productive of favorable results, because people in general do not resort to a classified directory when they require a physician, a lawyer, a CPA, or any other professional. There is a more resultful approach to the solution of the problem. It is in the attraction of the interest and good wishes of others to oneself.

Those who contemplate entering public accounting practice "on their own" will do well, 'ere they launch their ship, to consider the manner in which good will is developed.

The public accountant is occasionally asked to compute the estimated money value of the good will of a business, the control of which has changed or is about to change. In a case of this sort, the thought behind the valuation of good will, and the willingness of the vendee to pay for it, is the belief that past and present customers will patronize the new owners. With the mechanics of such value determination this scribe is not presently concerned. These lines will deal with the inception rather than the disposal of an intangible asset which is based on well wishes and kindly feeling.

Although good will in the professions also is the result of skill, accomplishment, and fair dealing, it is important earlier in the history of self-employed practitioners than in the case of merchandising endeavors, because it is through the good wishes and kindly interest of satisfied *first* clients that a CPA is enabled to build a practice. To gain that interest *Service* is the watchword which must remain foremost in the CPA's mind. Once a fee, or the method of its computation, is decided upon, all efforts should be devoted to the best possible performance, regardless of whether the estimated compensation will result in a profit or in a loss. Many unsatisfactory—from the financial viewpoint—engagements may be undertaken before the entrepreneur acquires the knack of estimating fairly both to the client and himself, but by performing his contract always to the best of his knowledge and ability, he will earn the respect and good will of the client. The latter in most cases, is, after all, a business person and soon will know if the CPA has sustained a loss. If the account is worth retaining, the loss will be made up in two ways: one, by future retention under a different arrangement; and the other through recommendation by the client to his business friends. The CPA should not limit himself to poring over accounts. As the examination progresses he should note suggested changes in organization, routing of operations, safeguards, etc., for later discussion with the client. In other words, he should observe through the eyeglasses of the client what is happening in that particular establishment. Thus starts the good will development which will produce many more clients than paid advertising ever will do.

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Mr. Byrnes is a consultant to the accounting firm of Byrnes and Baker, C.P.A.'s. He was formerly an associate professor of accounting at Columbia University. He is a co-author of the text entitled, "Auditing."

Another aid in the growth of a practice is the attitude of the field and office staffs of the CPA. The good wishes of these persons are as necessary as are those of the clients. Sustaining a staff member when a client indicates disapproval of the zeal of a senior or junior assistant in pursuing some elusive link, will pay well in loyalty of the employee to the CPA. Thought should be given also to the conditions under which the field staff works, and rests; by this is meant that well lighted and efficiently equipped working space be insisted upon in client's offices and factories, and also that pleasant and comfortable transportation and quarters be provided on out-of-town assignments. The dignity of the profession should be upheld, thus imbuing the assistants with pride in their vocation.

Staff members should be encouraged to continue their studies beyond the acquisition of the CPA certificate. They should be asked to write articles for the accountancy journals, to give talks to their associates and others, and urged to participate in the activities of national and state accounting societies. All of these provide excellent preparation for later preferment.

The principals and staff members should join welfare groups interested in the education and health of their communities, and also keep abreast of happenings in this rapidly changing world. And, even as they profit from the experiences of their vocational brethren as recited in professional periodicals, so also should they pass along their unusual observations, thoughts, and ideas.

In summation, it may be said that the foundation—and growth—of a CPA practice is GOOD WILL, resulting from (1) the efforts of principals and staff to render the most service at all times under all conditions and circumstances, (2) the strict observance of ethical standards, (3) the mutual respect and kindly feeling of firm members and firm employees, (4) the earned high regard of fellow practitioners, and (5) unselfish devotion to the public welfare. With such a working combination plus a pleasing personality—which if naturally lacking may be developed just as an inferiority complex may be overcome—a happy future in accountancy for any practitioner, young or old, is assured.

AN ADIRONDACK VIEW

Are you a mathematician? Wish I, too, knew all the answers, especially the right ones. But guess the answer to this one has been cornered.

On the Strong Vocational Interest Blank, for accountants & CPAs, we find the mathematicians way down toward the bottom—20 lines removed from us. In other words, the kind of guys that are apt to be good CPAs are *not* apt to be good mathematicians—and vice versa.

This looks a bit odd to us who are throwing figures around 40 hours per week (more or less). If it looks odd to you here is a simple 3-question test that you need to pass 100% if you want to think you are anything of a mathematician.

1. Do you have a slide rule constantly at hand for use in your accounting work?
2. Have you a table of logarithms handy so you can use it?
3. Do you know what a duo-decimal is?

We made a trial run of this test on a group of five CPAs at the Saranac Conference. All got a grade of O. It's likely that our figure work is arithmetic rather than mathematics. Perhaps they are right at the Saturday Nite Bridge Club when they say, "You keep the score, you're a CPA."

Leonard Houghton, C.P.A.
of the Adirondack "Chapter"

New York State Tax Clinic

Conducted by Benjamin Harrow, C.P.A.

Medical Expense Deduction

Under Section 360.15 of the income tax law expenses for medical care of a taxpayer, his spouse or a dependent are deductible from gross income on a limited basis. Only expenses in excess of 5% of net income, computed without deduction for medical expenses, may be deducted and the maximum deduction in the case of a single individual not a head of a family is $750. The maximum deduction for a husband and wife who file a joint return is $1,500.

What is the maximum deduction where a wife dies during the taxable year and the husband may not file a joint return? Under the strict provisions of the law it would seem that the taxpayer is limited to a maximum deduction of $750. However, the taxpayer is prevented from filing a joint return only because a joint return may not be filed if husband and wife are not living together at the end of the taxable year. The Regulations (Article 202) permit a deduction for the medical expense of a spouse if it was made at the time she was a spouse or if she was a spouse at the time of payment. If the rationale of this provision is applied to the above situation it would seem that the maximum deduction of $1,500 could be taken.

There is a third possible solution based upon the provision in the law permitting a proration of the personal exemption where the status of a taxpayer changes during the year. The maximum medical deduction could be prorated on the basis of a change in status. Our own opinion is that the maximum deduction of $1,500 should be allowed.

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Mr. Harrow has been a member of the American Institute of Accountants since 1922 and is a member of the New York Bar. He is now serving on the Society's Committee on Federal Taxation, and is Chairman of its Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

Allocation under the Unincorporated Business Tax Law

A non-resident partnership consisting of four partners maintains a showroom in New York in which samples of a manufactured product are shown. The showroom is in charge of a salesman who is a resident partner. A non-resident partner comes to New York twice a week merely to purchase raw materials which are shipped direct to Boston. Two questions present themselves: Is the partnership doing business in the state so as to be subject to the unincorporated business tax? If so, what formula can be used for allocating the income of the partnership so that New York may reach fairly income that should be taxed under the law.

The law imposes a tax on non-resident partnerships carrying on a business in New York in whole or in part. The maintenance of a showroom in New York and the purchasing activi-

ties constitute the doing of taxable business. It should be noted that under the franchise tax law the maintenance of a selling office does not constitute doing taxable business. Under the franchise tax law there is a divided opinion in the Tax Commission as to whether purchasing activities in New York subject a foreign corporation to the tax.

The law (Section 386g) provides for an apportionment of income where an unincorporated business is carried on both within and without the state. The first method mentioned in the law is a separate accounting basis. If the books are so kept as to disclose the business earned within the state, a return on the basis of taxpayer's own books will be accepted, *provided the Tax Commission approves the basis used.*

A second method of apportionment is based upon the use of three factors, the average value of real and tangible personal property, total wages and salaries (including that of executives), and gross sales. A third method is one that the Tax Commission may prescribe if the other methods do not allocate a fair and equitable proportion of the net income of the business to the state. Under this method the Tax Commission could add additional factors or eliminate one or more factors from the prescribed allocation provisions.

In the situation mentioned above, since the purchasing activities of the partnership appear to be carried on in New York, it is our opinion that the Tax Commission could use purchases as a fourth factor to arrive at an equitable allocation.

Unemployment Insurance— Independent Contractors

Under Section 560, subdivision 3, of the law an employer is generally liable for contributions whenever he contracts with any person for any work which is part of the employer's usual business. However, if the contractor performs work for anyone who wishes to contract with him and is found to be engaged in an independently established business, the independent contractor is liable for the contributions. Regulations 24, effective as amended on October 19, 1944, prescribe the procedure to be followed where an employer claims that he is not liable for contributions, but that the independent contractor is so liable. The employer is required to submit a copy of the agreement with the contractor and also certify the name and address of the contractor and other information on a form specially furnished for this purpose. This information is required to be submitted during the first ten days following any calendar quarter during which an employer contracted for such work and hence claims he is not liable for contributions. The employer must nevertheless file special contribution reports and quarterly payroll reports even though it has been held that he is not liable for contributions. A central agency of the industry may file a copy of a contract with a contractor and certified lists, instead of the employer.

Unemployment Insurance— Transfer of Assets and Joint Accounts

Section 577 Subdivision 7a of the law considers the treatment of contribution rate credits in the case of an employer who sells his business to a new employer. The old employer and the new employer are treated as a joint account "if some of the employees of a qualified employer have been transferred to another employer, provided the functions in which they were engaged and the assets, if any, relating to such functions are also transferred to such other employer and provided further the transferring employer discontinues such functions upon the transfer."

Under Regulation 26 the new employer must report in writing the acquisition of the assets of the seller, his name and the date of acquisition.

In computing the tax credit of the acquiring employer the period of liability of both employers is considered. Notice of the acquisition must however be given to the Division of Placement and Unemployment Insurance not later than November 30 of the calendar year immediately following the year in which the transfer occurs.

Foreign Corporations—License Fee

A domestic corporation pays an initial tax at the time it is organized. The tax is based upon the authorized capital stock. A foreign corporation is likewise subject to a tax at the time it first comes into the state to do business. Upon the filing of the certificate of authorization to do business, a foreign corporation must pay an entrance fee of $100. In addition, a foreign corporation must pay a license fee based upon the *issued* capital stock *employed in the state.* The license fee is computed and included in the first annual report by the foreign corporation, either under Article 9 or Article 9A.

Whenever the capital structure of the foreign corporation is changed an additional license fee is payable. For example, suppose a foreign corporation changed its capital structure during the month of February, 1950. A license fee on the increased capital is payable. In response to an inquiry as to when this increase should be reported, Deputy Commissioner Kassell issued an opinion that the recomputation of the license fee on the basis of the new capital structure should be made in the report due for the year in which the change occurred. In the example cited that would be the report due May 15, 1951. That is so even though the changes in capital occurred before the due date of the report for the previous base year.

New Franchise Tax Returns for Certain Fiscal Year Corporations

The 1950 legislature changed the filing and payment dates for corporations with fiscal years ending July 31, August 31, September 30, October 31 and November 30. For such corporations the report and the first payment are due three and one-half months after the close of the corporation's fiscal year. The second payment is due no later than the first day of the eighth month after the close of the fiscal year.

New forms 3CT fiscal and 3 CT-1 fiscal have been issued for corporations using fiscal years ending after July 1, 1950, and before December 1, 1950. These forms are generally similar to those used for calendar year corporations or those for corporations with fiscal years ending after June 30, 1949, and before July 1, 1950. The use of a new form for those corporations whose returns are due three and one-half months after the close of a fiscal year is to simplify the administrative procedure within the department, particularly in keeping track of the due dates for the second payment.

May 15 is still the due date for filing returns of corporations reporting on a calendar year basis, and those on a fiscal year basis ending January 31.

General Business and Financial Tax

The gross receipts tax return must be filed each year by June 15. The tax is based upon the receipts for the calendar year preceding the due date. A new local law has added a provision with respect to persons subject to the tax that cease to do business. Such persons are now required to file a return within thirty days after they cease to do business. In addition, the tax is due immediately at that time.

Registration of Motor Vehicles

The New Jersey Supreme Court recently decided a case[1] holding that a New Jersey corporation must register motor vehicles that enter the state even though the vehicles are based outside the state, registered in that state where they are based, and enter New Jersey only in the course of a continuous interstate journey.

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[1] *State* v. *Garford Trucking, Inc.* (4/24/50).

The New York law is different. However, the address given on the registration must be that of the state where the vehicle is based and where presumably it is registered. If the vehicles come into the state occasionally and do any intrastate business, registration would be required. Such a vehicle would thus be subject to registration in more than one state. The New York rule with respect to New York corporations would apply also to motor vehicles of foreign corporations qualified to do business in this state. The New York Motor Vehicle Bureau recently stated the New York requirements in view of the New Jersey decision.

General Business and Financial Tax

A recent amendment to the gross receipts tax law was generally interpreted to mean that non-resident sellers who do not maintain offices in the city would not be subject to the tax. In the July, 1950, issue of the New York State Tax Clinic we commented on the amendment. The Comptroller has taken the position that non-resident sellers who make sales within the city through a manufacturer's sales representative, an individual sales agency, a resident salesman, "or in any other similar manner" would be subject to the tax.

Under the franchise tax law mere solicitation of business does not constitute doing taxable business within the state. The gross receipts tax being an excise tax on the right to do business in the city should be similarly construed. The issue will undoubtedly be submitted to the courts for final determination.

Taxation of Earned Income

Taxpayers in the professions, actors, and others whose income from year to year may be irregular are at a disadvantage taxwise, particularly in comparison with taxpayers whose incomes are more regular from year to year. Section 107 of the Internal Revenue Code was designed to relieve this situation to some extent but, because of fluctuating tax rates on top of fluctuating income, this does not completely meet the problem. Under our state income tax law there is no provision comparable to 107. The American Bar Association has been studying this problem through a special committee which will submit a report at the 11th annual meeting of the section of Taxation to be held September 16-20, 1950 at Washington, D. C.

Various devices for averaging income are being proposed. One device is the "progressive" averaging plan proposed by M. Francis Bravman and discussed by him in the January, 1950, issue of the Columbia Law Review. Under this plan income would be averaged over three periods in a person's life, the period up to 21 years of age, the period from 21 to 30 years, and the period from 30 years to death. The income for each year of the averaging period would be added to that of all preceding years and the total divided by the number of years in the period to date. The individual would thus pay his tax each year on the actual average of his income.

Another device is the one proposed by Thomas N. Tarleau in 1948, before the House Ways and Means Committee. Under this plan an individual would receive a credit against his tax every five years, measured by the excess of taxes paid for five years over the taxes for the years computed on the average annual income for the five years. No year could be used more than once in any averaging cycle.

Another plan is that proposed by Richard Mullens, a member of the special committee. This plan uses the moving average device. Each year a taxpayer could elect to compute an alternative tax based upon the difference between his taxes for the four preceding years and what his taxes would have been for the current and the four preceding years if his income for the five years had been divided equally among those years.

Professor William Vichrey of Columbia University has proposed a lifetime averaging plan. Under this plan the income for the current year is added to all preceding years. The tax is based upon the difference between the taxes paid in all preceding years and what the tax would have been in those years and the current year if the income had been received in equal amounts each year.

All plans are being considered by the committee. In addition the committee is enlisting the interest of the Committee for Economic Development, the National Association of Manufacturers, the Brooking's Institution, and the United States Chamber of Commerce particularly on the economic effects of the proposals.

The Receipts Factor in the Allocation Formula

In Report Bulletin 2 of the New York Tax Service, (July 24, 1950) Prentice-Hall has an interesting editorial discussion on the Sales Factor in Uniform Income Allocation. In reading it we were reminded of the consideration the Tax Advisory Group gave to this problem in 1944, when the revision of Article 9A was under discussion. The Tax Advisory Group had decided to adopt the socalled "Massachusetts" formula for apportioning income. One element in this formula is the sales or receipts factor and the discussion was concerned chiefly with the question of the situs of the sale. Some of us argued that the sale should be allocated to the state to which the goods were sent. The representatives of the State Tax Commission opposed this view since it obviously might eliminate considerable income from taxation in New York. They emphasized the fact that the State of New York may be the place where the sale was negotiated and that fact should be given some weight in an allocation formula. It was then suggested that the sales or receipts factor should be weighted, 50% to the state of destination of the merchandise sold, and 50% to the state from which the salesmen making the sale operate. In our opinion, that would have been a more realistic recognition of the interstate elements in the transaction. That too would probably have siphoned off more income from New York than the Tax Commission was willing to concede at that time.

Under the present rule for allocating receipts, the situs of the sale is New York if the property is located in New York at the time of the receipt of *or* appropriation to the orders, irrespective of where the orders were received or accepted. If the order is received *or* accepted in New York and the property at the time is not located at any *permanent* or continuous place of business maintained by the taxpayer outside New York, the situs of the sale is also New York.

Accounting at the S.E.C.

Conducted by Louis H. Rappaport, C.P.A.

Pro Forma Financial Statements

Pro forma financial statements are not of importance solely in documents prepared for filing with the S.E.C., but they are most often prepared and used in registration statements filed under the Securities Act of 1933.

Pro forma statements are of many kinds. There are pro forma balance sheets which give effect to the receipt of funds from the proposed sale of new securities and the application of the proceeds toward payment of liabilities and purchase of new assets. There are pro forma balance sheets which set forth the financial position of two or more business enterprises whose merger is proposed. There are pro forma income statements of merged companies which previously operated as separate enterprises; the combined statement of their operations for the period prior to merger is intended to portray the operating results which might have been obtained had the companies been merged at the beginning of or prior to the period covered by the statement. When a company is no longer affiliated with other companies, pro forma statements may attempt to present the operating results that would have obtained had the company not enjoyed the benefits of consolidated tax returns. The number and variety of pro forma statements is almost endless.

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However, recognition of surplus charges and credits, adjustments of federal income taxes, and other similar adjustments in the years to which they apply does not change the essentially historical character of statements, and statements so adjusted should not be labeled "pro forma."

Pro forma statements often help the reader comprehend an otherwise confusing situation; sometimes they are essential to a proper understanding. Often these statements are more illuminating than the so-called "actual" statements on which they are based, and the public accountant must be alert to see that the prospective investor is furnished not only with all the financial information he needs but also that the information is presented in the most convenient and useful form. This latter consideration frequently dictates the use of pro forma statements, and in recent years prospectuses have placed increasing emphasis on these statements. There has been a tendency to abuse them, and this was the subject of extended discussion at a meeting in 1946 attended by representatives of several investment banking, legal, and accounting firms. It was the consensus of those present that it is not desirable to restate in an earnings summary extending back over several years interest and other fixed charges on the basis of securities to be outstanding in the future. When it is considered necessary to make such a computation in order to indicate the balance of earnings applicable to equity securities, the computation should be limited to the last fiscal year presented and, preferably, indicated in an explanatory note.

Institute Pronouncements—In 1923, the membership of the American Institute of Accountants adopted the recom-

mendations of a special committee on the subject of pro forma statements reading, as follows:

> I. The accountant may certify a statement of a company giving effect as at the date thereof to transactions entered into subsequently only under the following conditions, viz.:
>
> (a) If the subsequent transactions are the subject of a definite (preferably written) contract or agreement between the company and bankers (or parties) who the accountant is satisfied are responsible and able to carry out their engagement;
>
> (b) If the interval between the date of the statement and the date of the subsequent transactions is reasonably short —not to exceed, say, four months;
>
> (c) If the accountant, after due inquiry, or, preferably after actual investigation, has no reason to suppose that other transactions or developments have in the interval materially affected adversely the position of the company; and
>
> (d) If the character of the transaction to which effect is given is clearly disclosed, i.e., either at the heading of the statement or somewhere in the statement there shall be stated clearly the purpose for which the statement is issued.
>
> II. The accountant should not *certify* a statement giving effect to transactions contemplated but not actually entered into at the date of the certificate, with the sole exception that he may give effect to the proposed application of the proceeds of new financing where the application is clearly disclosed on the face of the statement or in the certificate and the accountant is satisfied that the funds can and will be applied in the manner indicated. It is not necessary that the precise liability shown in the balance sheet before adjustment should actually be paid out of the new money. It is sufficient, for instance where the balance sheet before the financing shows bank loans, if the proceeds are to be applied to bank loans which are either identical with or have replaced the bank loans actually outstanding at the date of the balance sheet. Ordinarily, however, the accountant should not apply the proceeds of financing to the payment of current trade accounts payable, at least not against a normal volume of such current accounts payable, because there must always be such accounts outstanding, and the application of new moneys against the outstandings at the date of the balance sheet results in showing a position which in fact could never be attained. The accountant may usually best satisfy himself that the funds will be applied as indicated by getting an assurance from the issuing house on the point.
>
> III. In any description of a statement or in any certificate relating thereto it is desirable that the past tense should be used. It should also be made clear that the transactions embodied have been definitely covered by contracts.
>
> IV. When the accountant feels that he cannot certify to such a hypothetical statement, probably because of the length of the period which has elapsed since the accounts have been audited, he may be prepared to write a letter, not in certificate form, stating that at the request of the addressee a statement has been examined or prepared in which effect is given, in his opinion correctly, to proposed transactions (which must be clearly specified). Such letters should be given only in very special cases and with the greatest care.

S.E.C. Rules—The S.E.C. has a rule under the Securities Act of 1933 regulating the use of certain kinds of pro forma statements; a similar rule was promulgated under the Securities Exchange Act of 1934. The rule under the 1933 Act is as follows:

> Rule 170. Prohibition of Use of Certain Financial Statements.
>
> Financial statements which purport to give effect to the receipt and application of any part of the proceeds from the sale of securities for cash shall not be used unless the sale of such securities is underwritten and the underwriters are to be irrevocably bound, on or before the date of the public offering, to take the issue. The caption of any such financial statement shall clearly set forth the names of the underwriters and the assumptions upon which such statement is based. The caption shall be in type at least as large as that used generally in the body of the statement.

It will be noted that there are similarities between the S.E.C. and the Institute rules quoted above, but there are also differences. Under the S.E.C. rule, if the underwriters are not to be *irrevocably* bound on or before the date of the public offering to take the issue, pro forma statements giving effect to the financing may not be used. If a public accountant is called on to assist in the preparation of a pro forma balance sheet of the type under consideration,

he should ascertain whether the underwriters are to be irrevocably bound on or before the public offering date to take the securities. An agreement is considered by some underwriters to be "firm" despite the existence of a clause by which the underwriter may exercise an "out" if economic, political, market, or other factors at the time of the proposed offering are such as to make the offering, in the opinion solely of the underwriter, unwise. Under Rule 170 the agreement must be more than firm; at the date of the offering the underwriters must be irrevocably bound.

At the time the pro forma balance sheet is prepared the underwriting agreement is usually tentative—it does not become final, in fact, until shortly before the effective date of the registration statement when agreement has been reached as to the price of the securities. Usually, however, there has been agreement in principle as to the nature of the underwriting commitment, and the accountant may proceed on oral assurance from the company or its counsel that the underwriters will be irrevocably bound on the public offering date. He can satisfy himself on this point by reading the final agreement before the effective date.

Certification of Pro Forma Statements—There is no objection to issuing a certificate covering a pro forma *balance sheet* included in a prospectus provided:

(1) the underlying financial statements have been examined by the certifying accountant; and

(2) there is compliance with S.E.C. Rule 170, if applicable.

A suggested form of certificate covering a pro forma *balance sheet* follows:

To the Board of Directors of
X Corporation:

We have examined the accompanying pro forma balance sheet of X Corporation as of (date). This balance sheet is based upon the accompanying balance sheet of X Corporation as of (date) (which appears hereinafter with our certificate) and the pro forma adjustments identified in the headnote.

In our opinion, the accompanying pro forma balance sheet of X Corporation presents fairly, in conformity with generally accepted accounting principles, the financial position of the company as it would have appeared at (date) had the transactions set forth in the related pro forma adjusting entries been consummated at that date.

When the public accountant has not examined the underlying financial statements, he is in no position to certify the pro forma statements derived therefrom.

The certification of pro forma income statements or earnings summaries presents a more difficult problem for the public accountant. There are situations in which he may with justification object to having his name identified publicly with certain types of such statements or summaries. He should not refuse to certify pro forma income statements or earnings summaries that merely add the historical results of two or more businesses which have been combined into a single enterprise. This rule is not altered by the fact that intercompany transactions, if any, are eliminated in the pro forma statement. Other pro forma statements, however, should be considered on their merits, and the auditor should bear in mind that these statements are sometimes abused.

The Shoptalkers

Conducted by Lewis Gluick, C.P.A.

The Shoptalkers Reminisce

As pointed out from time to time, and now repeated for the benefit of those who came in late, the characters in these dialogues are all synthetic. Oldtimer was originally conceived as combining the best elements of two fine CPA's. One of them has since gone to his reward. The other has retired to a well-earned rest, but his keen mind still keeps pace with current professional matters. Recently he told the Shoptalker that one of he joys of old age was the "right to reminisce."

Other Oldtimers have told the Shoptalker some pertinent stories, and the Shoptalker himself can chip in a few. So instead of the Tuesday Lunch Club, we are this month going to set the stage at the 19th hole, where three Oldtimers have foregathered, and are exercising their right, with the comparatively youthful Shoptalker as an interested audience.

Oldtimer Tom: I think one of the most interesting developments is the literary death of single-entry. In my day we learned about it at the start, even though we did not practice it much. But I'll wager it is fifteen years since the last question on that subject appeared on the CPA examination. Not only that, but Paton's newest Handbook doesn't even have the subject listed in the index.

Oldtimer Dick: A point well taken. My grandson, who's just started his college course, is using a text in which, as far as I can make out without reading every line, the subject isn't even mentioned. And I think that's a pity.

Oldtimer Harry: Well, the theory must be that if the student never hears of it, he won't be tempted to use it.

Shoptalker: I don't think total exclusion is good. Finney gives a brief treatment in his second semester, enough to let a student recognize single entry if he meets it.

Tom: Which, of course, he never will. I'm eighty, young man, and I practiced bookkeeping and accounting for almost half a century. Went to work at fifteen, and I never have seen a pure single entry system.

Dick: Nor I. Always hybrids, and I don't like 'em. To my way of thinking, the failure to teach single entry destroys the continuity of the subject. It has been said that accounting students who were taught the history of the subject, concurrently with the beginning course in theory and practice, learned more. But Green's book on the subject is out of print, and any junior who wants to learn the history of his profession has to do a lot of personal research. The local library never had a copy of Green.

Harry: A little more research won't harm 'em, but they ought to get some enlightenment as to what to search for.

Tom: That's the ticket! Columbus had an idea of something to search for, and he didn't invent it. Modern boys don't even know how to sharpen a pen-

Lewis Gluick, C.P.A., who has been a member of our Society since 1924, has resumed the practice of accountancy in the East.

Mr. Gluick, who had been writing under the name of The Shoptalker in other magazines since 1928, recently brought his group of Shoptalkers to our columns. We would welcome your acceptance of his invitation to participate in the discussions.

cil. Absolute fact! One of the last audits I made in the field was just before I retired, two years ago. No use boring you with how I came to be on it, but there I was. The client's office pencil sharpener broke. I just sharpened my pencils with the knife I always carried in my audit bag. Same knife for almost forty years. I passed it to the men I had with me. The senior used it. The junior couldn't. Positive fact! Twenty years old, and he had *never* before tried to sharpen a pencil any way but with a machine.

Shoptalker: And now they have electric machines. Just stick in a pencil, and the motor starts.

Dick: Trust the ex-chairman of the machinery committee to get that in.

Harry: It isn't the pencil sharpening that worries me. It is the dependence on machines and specialists to do things that may lead to national ruin. Obviously that junior of yours never had been a Boy Scout. We ought to encourage scouting. But all this talk about the rugged individualism of the American is getting to be history. The really rugged individual today is the survivor in Europe, who has to do without the luxuries which we rich Americans deem necessities.

Dick: Aren't you getting a bit pessimistic? You are giving this youngster an idea that the old days were the only good days, and that is what old men have been doing ever since Methuselah. I thought you had better perspective than that. I have. I want no part of some of the old days, like when my little brother died of diphtheria. The thing that I protest against is that in gaining new "goods," we also lose old "goods."

Shoptalker: For every debit there must be a credit.

Harry: That's all right for an art like bookkeeping. And was it Newton or Kepler who proved that, for every action in the physical universe, there must be an equal and opposite reaction? What baffles me is that we can't have single entry minds. Where we could absorb the new *"goods"* and, if not banish the old *"bads,"* at least exclude the new *"bads."* Now you take these new electronic accounting machines—just lineal descendants of the Arabian abacus. Do you imagine for one minute that modern bureaucracy could exist without the typewriter and mimeograph machines, or that taxation could be as intricate as it is without all the other mechanical devices. Bureaucrats had their counterparts in the days of Caesar, but the undue expansion of government regulation could never have taken place or continue without modern machinery.

Dick: No quarrel with that.

And with that, the Shoptalker signs off for the month. All Oldtimers are invited to send in their reminiscences, of the good, or bad old days.

Book Reviews

(Continued from page 577)

the longest." No mention is made of the operating cycle of the business as a time factor. When the categorical statement is made that "prepaid expenses are not current assets" (p. 148), it is apparent that the current literature of accounting theory, and in particular the A.I.A. Accounting Research Bulletin No. 30, have been by-passed. Opposing points of view on the current problem of depreciation and high cost of fixed asset replacements are briefly presented, but the tone of the discussion could have been elevated by a reference to the viewpoint of the American Institute of Accountants as expressed in Accounting Research Bulletin No. 33.

The authors, who have brought to the preparation of the book a considerable background in industrial engineering and accounting, have manifested an acute perception of those phases of first principles in accounting which create difficulties for the student. Commensurately, they have applied keen pedagogical skill to their discussions in their attempts to guide the student over the trou-

(Continued on page 632)

A Note on the Social Security Act Amendments of 1950

By Samuel S. Ress

The new law makes 30 major changes in the programs established under the Social Security Act. There are 21 major changes in the Federal Old Age and Survivors Insurance Program. There are also changes in the Public Assistance Program relating to needy permanently and totally disabled persons, aid to dependent children, aid to the blind, etc.

Another widely publicized provision requires that administrative decisions by state agencies in certain cases be reviewed by the state courts prior to ruling by the Secretary of Labor on conformity questions under the Federal Unemployment Insurance Law. This amendment relates to the credits taken on Federal Unemployment Insurance Tax Returns because of payments made to the various State Unemployment Insurance Funds. If a state law be deemed not in conformity with the Federal Unemployment Insurance requirements by the Secretary of Labor, then an additional Federal Unemployment Tax liability would have to be paid by employers. Under such circumstances, their tax rate for State and Federal Unemployment Insurance could jump from 3 percent of the taxable payroll to 5.7 percent.

It is important that we become acquainted with the following major changes in the Federal Old Age and Survivors Insurance Program, because the payroll tax liabilities of both employers and employees have been changed substantially. They are as follows:

1. Extension of coverage to self-employed persons other than farmers and certain professional persons.
2. Coverage of regularly employed agricultural workers.
3. Coverage of regularly employed domestic workers.
4. Coverage of state and local government employees not members of retirement systems, through voluntary agreements between the state and the federal government, and compulsory coverage of certain employees of certain transit systems taken over by states or local governments after 1936.
5. Provision for voluntary coverage of employees of non-profit organizations at the option of the employer and the employees.
6. Coverage of certain federal employees not covered under retirement systems.
7. Coverage of employees and self-employed persons in Puerto Rico and the Virgin Islands.
8. Coverage of certain Americans employed outside the United States.
9. Inclusion of certain additional persons as "employees" for coverage purposes.
10. A substantial liberalization of the benefit formula for future beneficiaries.
11. Elimination of the increase in benefits for years of contributions to the insurance program.

Samuel S. Ress has been an Associate Member of our Society since 1936. He is a member of the New York Bar and holds the Juris Doctor degree from the New York University School of Law, and the B.B.A. degree from The City College (New York) School of Business and Civic Administration. He is a tax consultant and has been a specialist in the payroll tax field since the inception of Social Security and Unemployment Insurance Laws in 1936. He has drafted legislation related to unemployment insurance, health insurance, wages and hours and workmen's compensation.

Dr. Ress, who has written a number of articles which have appeared in *The New York Certified Public Accountant,* is a member of the Society's Committees on Clothing Manufacturing Accounting and on Labor and Management.

12. Liberalization of the method of computing "average monthly wage" for benefit purposes.
13. Increase in the wage base for benefit and contribution purposes from $3,000 to $3,600.
14. A substantial increase in benefits for current beneficiaries, averaging 77½ percent.
15. Liberalization of the eligibility provisions so as to make it easier for persons to qualify for benefits within the next decade.
16. Payment of benefits to dependent husbands and widowers of insured women workers.
17. Liberalization of survivors' insurance benefits with respect to insured married women.
18. Payment of the lump-sum death benefit in all cases of deceased insured workers.
19. Increase in the benefits for dependent parents and for the first child in a family from 50 percent to 75 percent of the primary insurance benefit.
20. Increase in the amount a beneficiary may earn in covered employment without loss of benefits from $14.99 to $50, and elimination of the retirement test at age 75.
21. Provision of wage credits of $160 for each month of military service during World War II.

Changes in Tax Rates and Base

Taxable wage base—The limit on total earnings on which benefits are computed and contributions paid has been increased from $3,000 to $3,600.

Contribution schedule — Under the new law employers and employees will continue to share equally. The rate on each will be, as follows:

Calendar Years	*Rate*
1950-1953	1½%
1954-1959	2
1960-1964	2½
1965-1969	3
1970 and thereafter	3¼

The self-employed will pay 1½ times the above rates.

Changes in Coverage

The new law extends compulsory coverage under old-age and survivors insurance to about 7½ million persons, and voluntary coverage will be available for about 2 million employees of state and local governments and non-profit organizations. The specific changes in coverage are as follows:

Self-employed—The new law covers approximately 4¾ million self-employed persons whose annual net income from self-employment is at least $400. It does not cover self-employed farmers, physicians, lawyers, dentists, osteopaths, chiropractors, optometrists, Christian Science practitioners, naturopaths, professional engineers, veterinarians, architects, funeral directors, or certified, registered, licensed, or full-time practicing public accountants.

Agricultural workers—The new law covers certain borderline agricultural labor, such as processing workers. In addition, it covers "regularly employed" agricultural workers. A farm worker is "regularly employed" if he has 3 months' continuous service for one employer before coverage starts, and thereafter employment by that employer on a full-time basis for at least 60 days in a calendar quarter with cash wages of at least $50 for services in the quarter.

Domestic workers—The new law covers approximately 1,000,000 domestic workers not in farm homes (those in farm homes would be covered as agricultural workers). A domestic worker is covered if employed by a single employer for at least 24 days in a calendar quarter with cash wages of at least $50 for services in the quarter.

Employees of non-profit organizations—The new legislation contains the following provisions for voluntary coverage of employees of non-profit organizations:

1. If the employer does not agree to pay his share of the contribution, the employees cannot be covered.

2. Even if the employer agrees to pay his share, none of the employees can be covered unless two-thirds of them accept coverage.

3. If two-thirds or more of the employees accept coverage, those employ-

ees who do so, plus any employees hired in the future, will be covered.

4. Coverage must be for an initial period of at least 8 years, and in addition 2 years' advance notice must be given before coverage can be terminated. Thus the minimum period of coverage is 10 years.

Ministers and members of religious orders will continue to be excluded.

Employees of state and local governments—The new law provides voluntary coverage for approximately 1,450,000 state and local government employees through agreements between the states and the federal government. Public employees covered under a retirement system on the date when the agreement is made applicable to the governmental unit which employs them cannot be covered under old-age and survivors insurance.

In addition, the new law extends compulsory coverage to employees of transit systems taken over by state or local governments after 1936 unless they are covered by a general retirement system (if the transit system was taken over before 1951, the employees are covered even if under a general retirement system unless that system is protected by the State constitution).

Federal civilian employees not under a retirement system—The new law covers employees of the United States government, or of wholly owned corporations of the United States, who are not covered under any federal retirement system. This results in covering most short term federal employees, including those serving under temporary appointment pending final determination of eligibility for permanent or indefinite appointment. In addition, employees of the following instrumentalities of the federal government are covered: national farm loan associations; production credit associations; federal credit unions; the Tennessee Valley Authority (if not under the TVA retirement system); post exchanges and similar activities under the National Defense Establishment; state, county and community committees under the Production and Marketing Administration; and certain employees of the Federal Reserve System.

Puerto Rico and the Virgin Islands—The new law extends coverage to employees and the self-employed in the Virgin Islands and (if requested by the Territorial Legislature) in Puerto Rico, on the same basis as in the continental United States.

Americans outside the United States—The new law extends coverage to Americans employed outside of the United States by an American employer, and to employees on American aircraft outside of the United States.

Definition of employee—The new law defines an employee as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee," and also covers as employees (1) full-time life insurance salesmen, (2) agent-drivers or commission drivers engaged in distributing meat or bakery products, vegetables or fruit products, beverages (other than milk) or laundry or dry cleaning services, (3) full-time traveling or city salesmen (other than house-to-house salesmen) taking orders from retailers, hotels, wholesalers, jobbers and contractors, and (4) industrial homeworkers who earn at least $50 in a calendar quarter if they are subject to regulation under State law and work in accordance with specifications prescribed by the employer.

The effective date for the new coverage will be January 1, 1951.

Changes in Benefit Amounts

Current beneficiaries — Under the new law, persons currently receiving benefits will have their benefits increased on the average by about 77½ percent. Increases will range from about 50 percent for the highest benefit groups to about 100 percent for low-benefit groups. The average primary benefit of approximately $26 per month

for a retired insured worker will be increased to about $46. The following table shows the increased amounts which will be payable:

BENEFIT AMOUNTS

A—Benefit for a Retired Single Man

5 Years of Coverage

Average Monthly Wage	*Previous Law*[1]	*New Law*[2]
$100	$26.25	$50.00
200	36.75	65.00
250	42.00	72.50
300	42.00	80.00
400	42.00	80.00

30 Years of Coverage

Average Monthly Wage	*Previous Law*[1]	*New Law*[2]
$100	$32.50	$50.00
200	45.50	65.00
250	52.00	72.50
300	52.00	80.00
400	52.00	80.00

B—Benefits for a Retired Man and Wife

5 Years of Coverage

Average Monthly Wage	*Previous Law*[1]	*New Law*[2]
$100	$39.38	$ 75.00
200	55.13	97.50
250	63.00	108.80
300	63.00	120.00
400	63.00	120.00

30 Years of Coverage

Average Monthly Wage	*Previous Law*[1]	*New Law*[2]
$100	$48.75	$ 75.00
200	68.25	97.50
250	78.00	108.80
300	78.00	120.00
400	78.00	120.00

NOTE 1—Forty percent of the first $50 plus 10 percent of the next $200, increased by 1 percent for each year of coverage.

NOTE 2—Fifty percent of the first $100 plus 15 percent of the next $200; no increment for years of coverage.

QUARTERS OF COVERAGE REQUIRED TO BE FULLY INSURED

Age attained in first half of 1951	*Old Law*	*New Law*	*Age attained in first half of 1951*	*Old Law*	*New Law*
76 or over	6	6	64	30	6
75	8	6	63	32	6
74	10	6	62	34	6
73	12	6	61	36	8
72	14	6	60	38	10
71	16	6	59	40	12
70	18	6	58	40	14
69	20	6	57	40	16
68	22	6	56	40	18
67	24	6	55	40	20
66	26	6	50	40	30
65	28	6	45 or under	40	40

The benefit increases for persons now on the benefit rolls will be effective for the month of September, 1950, as will most of the other new benefit provisions.

Benefits based on the new benefit formula will first be paid in May, 1952. Persons coming on the rolls before that time will have their benefits computed under the present formula with the increases provided for those now receiving benefits.

CORRESPONDENCE

To the Editor of *The New York Certified Public Accountant:*

Mr. Lewis Gluick's *"Shoptalkers"* in the September issue of the *New York Certified Public Accountant* initiated a discussion of a tax problem which seems worthy of further consideration. The discussion centered itself around a partnership of three individuals one of whom sold his interest to the others for $12,000. At the date of sale the capital account of the seller reflected a balance of $14,000. Basically, Mr. Gluick was concerned with the tax significances of this transaction.

As far as the seller is concerned, his position has been made quite clear by a long series of court decisions in which the Tax Court and six of the Circuit Courts of Appeal concur. He has incurred a capital loss arising from a sale of a capital asset, namely, his partnership interest. As such, his loss is subject to all of the limitations of capital losses, the full extent of which is dependent upon his holding period.

Max Swiren v. *Commissioner*
CCA-7, 7/14/50

M. E. Luhrs, et al v. *Commissioner*
Tax Court Memo Decision, 6/28/50

First National Bank of Mobile v. *Commissioner*
CCA-5, 7/7/50

Commissioner v. *Lehman*
CCA-2, 1948 (cert. denied)

Commissioner v. *Estate of Gartling*
CCA-9, 1948

Thornley v. *Commissioner*
CCA-3, 1948

Commissioner v. *Shapiro*
CCA-6, 1942 (cert. denied)

Could the seller have converted this loss from a capital into an ordinary loss? It is the writer's opinion that, if all of the interested parties were in agreement, this could have been achieved by the proper drafting of agreements. Thus, for example, Mr. Gluick's partners could have agreed to terminate the partnership first and to distribute its assets to the partners. There would be no taxable gain or loss at this point. The selling partner would then own property, presumably including inventory and fixed assets, with an aggregate tax basis of $14,000. He then could have retained his share of the partnership cash, collected his share of the partnership receivables and sold his share of the partnership inventory and equipment to the other partners for a consideration $2,000 lower than the tax basis attributable to the latter assets. This would presumably have netted him $12,000 and resulted in a loss from the sale of non-capital assets which would have been fully deductible as such. The distinction in treatment results from the fact that in the one instance, it is the partnership interest which is being sold; in the other, the transaction represents a sale of specific property.

The Shoptalkers, however, were apparently not concerned with the tax problem of the selling partner. The principal question troubling them was whether or not the acquiring partners had incurred a taxable gain by purchasing a $14,000 partnership interest for $12,000. The implication arising from the ensuing discussion was that such a gain had, in fact, been incurred by the purchasing partners and that, conceivably, an appraisal of the partnership assets to reflect that their true value was below book might not only offset this taxable gain, but could possibly produce a deductible loss.

The purchase of a partnership interest, regardless of any disparity between

its book value and its purchase price, does not produce a gain or loss to the purchasers. It represents the acquisition of a capital asset having a tax basis equal to the amount paid therefor. As long as the partnership agreement calls for the continuation of the company, the retirement of one of the partners would have no effect on the tax basis of the partnership assets. The acquiring partners would merely have a tax basis for a portion of their partnership interests which differed from the book value thereof. This situation has been passed upon affirmatively by the Fifth Circuit in a recent decision *(First National Bank of Mobile* v. *Commissioner, supra).*

Any appraisal of the assets in a situation such as the one described would undoubtedly support the propriety of the purchase price of the partnership interest but, within the framework of the facts given in Mr. Gluick's column, would have no tax effect upon the partnership or the acquiring partners.

It is interesting to note that where acquiring partners purchase the interest of a retiring partner at a discount and the agreement provides that such a transaction does not terminate the partnership, the basis of the business assets will remain unchanged in the hands of the partnership. Thus, the partnership as such will have a higher tax basis for its property than would be the case if it were terminated and the assets distributed to the remaining partners. In the latter instance, the discount arising from the acquisition of the partnership interest would have to be reflected as a pro-rata reduction of the tax basis of the property received by the partners from the partnership. Thus, it can be seen that the sale of a partnership interest at a discount, where the legal existence of the partnership continues despite the sale, is disadvantageous to the seller, since it produces a capital rather than an ordinary loss. It is, however, advantageous to the remaining partners from a tax point of view, since the partnership will retain the higher basis for the property.

The reverse is also true. Where the sale is at a premium and the partnership interest was held for more than six months, the sale of the interest rather than of the partnership property would prove advantageous to the selling partner by producing a long-term capital gain, but would be undesirable to the acquiring partners since the partnership would not acquire a higher base for its assets despite the payment of a premium for the interest.

The discussion by the Courts in two of the recent decisions involving sales of partnership interests may have important implications to taxpayers in analogous situations. In the *Swiren* case, a partner retiring from a legal firm sold his interest to the other partners. The partnership was on a cash basis. In arriving at the sales price of his interest, the retiring attorney included his proportionate share of unbilled fees and accounts receivable. It should be noted that had these items been collected by the law firm, the retiring partner would have been obliged to pick up his share thereof as ordinary income. By including them in the calculation of his sales price, these amounts were being reflected as part of his gain from the sale of the partnership interest. The Circuit Court, reversing the Tax Court, held that the entire amount of his gain arose from the sale of his interest and was, therefore, a capital gain. The Court recognized that the practical effect of this transaction was the conversion of future ordinary income into a present capital gain, but held for the taxpayer notwithstanding. *(Max Swiren* v. *Commissioner, supra.)*

In a similar case, the retiring partners sold their interests in an orange grove. In arriving at the sales price of their partnership interests, the value of the growing crop of oranges played an important role. The Commissioner reasoned that had this crop been sold, ordinary income would have resulted,

and the retiring partners would have been taxed with a proportionate share thereof. On exactly the same logic as reflected in the *Swiren* decision, the Tax Court ruled in favor of the taxpayers and considered the entire gain as long-term capital gains from the sales of partnership interests. *(M. E. Luhrs, et al.* v. *Commissioner, supra.)*

It would seem to the writer that in a proper situation comparable with the facts contained in these decisions, the definite possibility exists for converting ordinary income into a long-term capital gain by the process of selling a partnership interest before the realization of said income. As in the case of most tax-saving devices there can be no guarantees as to effectiveness. The Courts are not in unanimous agreement. (Cf. *Commissioner* v. *Smith;* CCA-2; 6/7/37 and *Doyle* v. *Commissioner;* CCA-4; 2/28/39). Furthermore, Congress has manifested a growing disapproval of these devices. The "collapsible corporation" provision in the proposed Revenue Act is indicative of this tendency. This clause could conceivably be broadened to cover sales of partnership interests. At the present moment, however, this procedure seems to bear the blessings of the Courts and should certainly be studied for applicability when the occasion arises.

Very truly yours,

JACK SCHLOSSER

Eisner and Lubin
New York, N. Y.

To the Editor of *The New York Certified Public Accountant:*

I am writing this in reference to the excellent article by Mr. Alexander M. Stollmeyer entitled "Presentation in Financial Statements Where Mortgage Exceeds Depreciated Cost of Property", which appeared in the September, 1950, issue of your publication.

At the outset, may I thank Mr. Stollmeyer for an interesting and thought-provoking article for those of his profession who are concerned with such problems. However, as he neared the conclusion of his article, the author branched out into the problem of "Unpaid Realty Taxes and Mortgage Interest." Unfortunately, he here brought up a subject that he only mentioned in passing, whereas it is one which has myriad of aspects worthy of a full article in itself. No doubt, it was the lack of space that turned the author away from a full coverage, but anything but a full coverage in our profession is a chance a publication cannot take.

I refer, of course, to the problem of statement procedure as to unpaid realty taxes. In New York City, this is a problem that soon branches out into many complexities, especially with the type of owner described by the author as equity investors in realty.

In New York City, unpaid realty taxes are more than just arrears. As soon as entered in the city lot books, they become liens attached to the property. After three years, the City has the right to sell these liens to outsiders at a borough sale. The prospective purchasers bid for the liens at face plus accrued interest on a basis of lowest interest, starting at 12%. In other words, the bidder offering to take over the lien at the lowest interest rate is sold the lien. If there is no bidding, the City takes over the lien at the maximum interest rate of 12%.

The third party who has purchased the lien on the property is now actually the holder of a first mortgage. He may hold the lien and collect interest; he may foreclose on the property and take title.

I have not even mentioned herein other possible technicalities as "upset sales", etc. Thus, balance sheet presentation varies, depending on the point in time in the possibilities presented above. Just the mere mention of tax arrears by the author does not do justice to the problems that may arise.

Very truly yours,

WILLIAM L. KRONTHAL

New York, N. Y.

To the Editor of *The New York Certified Public Accountant:*

In reading the article "Presentation in Financial Statements Where Mortgage Exceeds Depreciated Cost of Property" by Alexander M. Stollmeyer in the September, 1950, issue of *The New York Certified Public Accountant,* certain questions come to mind.

In rendering an opinion as to whether or not financial statements present fairly the financial position and results of operations of a type of company under discussion, it would be erroneous to attempt to segregate the principal asset, real estate, from the other assets in the Balance Sheet, as it would be to include rent income in the statement of operations and exclude the depreciation charge. The real estate owned is an integral part of the company, for without it the entire financial significance of that company is changed. To attempt to keep the cash or other assets in a compartment separate from the real estate would tend to present a dual picture of financial position, where one only exists. The basic problem underlying Mr. Stollmeyer's situation is one calling for a reconciliation among certain legal factors (property subject to a mortgage), economic facts (increase in market values) and accounting conventions (recording asset values at cost, etc.).

All three factors, the legal, the economic and the accounting have a material influence on this problem.

However, in suggesting a solution to the problem Mr. Stollmeyer has given precedence to the legal and economic factors, at the expense of certain accounting conventions. In the financial statement, that Mr. Stollmeyer presents, where the mortgage exceeds the cost of the real estate a surplus "Excess of mortgage over net property account" is credited. While this transation may indicate a shrewd type of refinancing or perhaps be indicative of the inflationary period we are in, it hardly creates a surplus. Perhaps the transaction better illustrates the conflict between certain accounting conventions and economic facts. Nevertheless, a higher mortgage will usually carry with it a greater magnitude of interest (assuming interest rates remain the same on the old and new mortgages, which is a fair assumption) and, in addition, the installments for amortization of principal will tend to be greater. Both these facts are important, as they will increase the drain on the other assets of the enterprise.

What is created in such refinancing is additional assets and, brushing aside the legal factor, additional liabilities. To convert an additional liability into surplus on the assumption that in the event the property is abandoned, sold, etc., is to toss aside the underlying concept that an opinion of financial statements is rendered on the assumption of a going concern and not a liquidating one.

The dilemma Mr. Stollmeyer presents is one arrived at by substituting legal and economic factors for accounting conventions. However, the dilemma is a real one, as the legal and economic factors do influence business transactions, the "meat" underlying accounting conventions. The situation is not one peculiar to real estate alone but is one that affects all items classified as fixed assets.

Until greater clarity on this situation comes about I would suggest treating the non-current portion of the mortgage as a fixed liability, with an appropriate note to the Balance Sheet, rather than create surplus items or dispense with a consistent method of depreciation.

Very truly yours,

Martin Greenblatt

Levittown, N. Y.

OFFICIAL DECISIONS *and* RELEASES

The following memorandum, prepared by the New York Credit Men's Adjustment Bureau, Inc., for distribution to all certified public accountants retained by the Bureau or by committees in estates in which it is interested, is published for the information of our members:

To All Accountants:

It is respectfully requested that when you serve in cases where the Bureau acts either as Secretary to the Creditors' Committee, or as Assignee, Receiver in Bankruptcy, Trustee in Bankruptcy, corporate officer or under corporate control, that you follow the procedure outlined below. This will make it possible for the administration of each case to be handled on a more efficient and prompt basis. Your co-operation is appreciated.

Cordially,

NEW YORK CREDIT MEN'S ADJUSTMENT BUREAU, INC.

(Sgd.) MORTIMER J. DAVIS,
Mortimer J. Davis,
Secretary and Manager.

June 27, 1950

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In cases where the Bureau acts merely as Secretary to a Creditors' Committee:

Promptly provide a schedule of all creditors of every classification, giving name, address and amount due each.

Do not use such terms as "due to bank", "due to money loan creditors", "due for rent, light, etc.", but specify to whom the money is due.

This also pertains to the various taxing authorities.

In cases where there is a liquidation either through assignment, bankruptcy or dissolution proceedings:

1. List all books and records, identifying each book with the number which corresponds to that appearing on the list. A copy of this is to be furnished to the Custodian or to the Bureau.
2. Submit a balance sheet as of the date of control.
3. Each item on the balance sheet should be supported by a detailed schedule.
   a) Where a portion of the accounts receivable is assigned, separate schedules should be made up showing the assigned accounts and unassigned accounts, giving names, addresses and amounts.
   b) A separate schedule of accounts receivable credit balances should be drawn up, and the total should appear on the Balance Sheet as a liability, and should not be used as a deduction of the Accounts Receivable.
   c) The same procedure should be used for Accounts Payable Debit Balances.
   d) Tax liabilities should be listed separately according to their various categories. Where taxes are levied by quarters, they should be so listed.

Tax returns should be made up promptly, so as to avoid penalties and interest assessments for delinquent filing. This pertains to *all* taxes even though the date for filing may be sometime in the future. Where quarterly returns are required, the returns should only cover a single quarter even though the concern may have operated a very short time beyond the last day of a quarter.

All tax returns should be made in duplicate and carbon copy should be furnished to the New York Credit Men's Adjustment Bureau, Inc. so that its files may be complete.

In cases where a typewritten report is to be rendered or the examination of the debtor's records will consume some time, preliminary schedules of the liabilities and assets should be promptly submitted, in order to avoid delay in the administration of the estate. These can be submitted in the form of carbon copies of the accountant's own work sheets.

In the event that specific items or operations are to be investigated, such instructions will be given. Otherwise the audit should be limited to preparing a balance sheet, and a profit and loss statement usually covering the period from the date of the last financial statement issued, up to the date of the balance sheet.

(Continued from page 622)

blesome areas. Problem material is included in the text and an accompanying comprehensive set of practice problems is available for separate purchase. The book merits consideration by accounting instructors who are conducting a one-semester terminal course, and may be profitably reviewed by those who wish to be initiated painlessly into elementary accounting processes, and would willingly forego comprehensiveness of treatment.

BENJAMIN NEWMAN

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Adelphi College, Garden City, N. Y.

The Economics of Industrial Management

By Walter Rautenstrauch and Raymond Villers. FUNK & WAGNALLS COMPANY, New York, N. Y., 1949. Pages: xxi + 451; $5.00.

The authors need no introduction, nor does the "Break-Even Chart." It is no surprise that this book was chosen by "Modern Industry" for publication. The inside of the paper wrapper says in part, "Those concerned with Industrial Engineering both in industry and in the colleges will find these features particularly valuable."

The book obviously has for its major purpose the introduction of the young engineering student to what has been described as the "dismal science"—Economics. As may be supposed knowing the background and connections of the authors, it does a splendid job in this respect. The book also serves to acquaint the engineering student with accounting philosophy.

The business executive may find the book a little academic, while the accountant may be further lulled into acceptance of the magic of numbers and equations.

The book is divided into three parts entitled respectively, "Visualizing the Business," "Industrial Cost Characteristics," and "The Business as Part of the National Plant." Part I seems mainly concerned with acquainting the industrial engineering student with both Economics and Accounting. It is principally of use to the accountant to remind him of the purposes of accounting as visualized by the industrial engineer, management consultant, and the business man. This should be particularly interesting and useful although, as might be expected, nothing is added to accounting technique except in the presentation of many specific applications of the "Break-Even Chart."

Part II seems principally concerned with acquainting the engineering student with accounting techniques. Unfortunately, it does little to point out the pitfalls of some accounting techniques, such as proration of certain costs. While various techniques of proration and their relative advantages are discussed, the great margin of error possible through the impossibility of determining some costs such as utilities consumption (steam and electricity) without direct measurement is not discussed.

Part III is general economics and, while essential in the training of any American college student and particularly essential in the training of engineers, accountants, and business students, is of no direct interest to the practicing accountant.

On page 48, the authors call attention to the fact that accounting statements in general record the past rather than the immediate present, and do not indicate trends or future events. This is a valuable observation, but the authors' method of improving on this condition is not apparent.

The discussion of financial ratios will be of use to the industrial engineering student but adds little to the knowledge of the accountant.

On page 65, the analysis of the financial statement from the standpoint of the management consultant whose function it is to increase profits by reducing expenses, besides being useful to the engineering student should also serve to bring the accounting viewpoint back to focus on the point that accounting should not only be reporting, but should also serve to indicate possible economies in operation.

On page 71, the necessity for setting standards is developed to some extent. The reader, however, is left with the impression that standards are only developed from past performance and nothing is mentioned as to the various sources of standards. The general subject of "Work Measurement" on which much has been done with time study in years past, and which is now being attacked in the office by means of micromotion analysis, is not discussed. The remainder of Part I is concerned with many interesting applications of the Break-Even Chart which are highly illustrative of this technique of analyzing business problems.

Part II has material helpful principally to the industrial engineer. Besides a review of financial computations, it also treats of the methods of justifying expenditures for equipment under the general heading, "Relative Worth of Alternates." The material on pages 264 and following serve to acquaint the engineer with typical accounting techniques, but do little to arouse in him a questioning attitude as to the real meaning and significance of some of these techniques, particularly those involving allocation of expenses to departments and products. It is to be regretted that on page 276 the authors give an example where the average wage is 66⅔ cents per hour with a range of from 40 to 90 cents in a book published in 1949.

HUXLEY MADEHEIM

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